OFFICE COPY

TRANSCRIPT OF RECORD

Supreme Court of the United States

OCTOBER TERM, ~~1959~~ 1960

No. ~~603~~ 23

KARL F. KNETSCH, ET AL., PETITIONERS,

vs.

UNITED STATES.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

PETITION FOR CERTIORARI FILED DECEMBER 21, 1959

CERTIORARI GRANTED FEBRUARY 23, 1960

No. 16356

United States
Court of Appeals
for the Ninth Circuit

KARL F. KNETSCH and EVA FAY KNETSCH,

Appellants,

vs.

UNITED STATES OF AMERICA,

Appellee.

Transcript of Record

Appeal from the United States District Court, Southern District of California, Central Division

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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italic; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in italic the two words between which the omission seems to occur.]

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*Page numbers appearing at bottom of page of Original Transcript of Record.

United States District Court for the Southern District of California

Civil Action No. 577-57 WB

CARL F. KNETSCH and EVA FAY KNETSCH,
Plaintiffs,

vs.

UNITED STATES OF AMERICA,
Defendant.

COMPLAINT

Income Tax

Plaintiffs, appearing by their attorney, Nola McLane, for their complaint against defendant, respectfully show to this Court, and upon information and belief allege as follows:

First Count

1.

This is an action arising under the Internal Revenue laws of the United States as hereinafter more fully appears. The jurisdiction of this Court is based upon Title 28, Section 1346 (a) (1) of the United States Code, Act of June 25, 1948, c. 646, 62 Stat. 689, 933 as amended by the Act of July 30, 1954, c. 648, sec. 1, 68 Stat. 589. [2]

2.

This action is brought for the recovery of $129,480.39 of income tax collected from plaintiffs for the calendar year of 1953 plus interest thereon at

the rate of 6% per annum from the date of payment.

3.

Plaintiffs are now, and at all times hereinafter mentioned, were residents and citizens of the State of California, County of Los Angeles, District of Southern California.

4.

On March 15, 1954, plaintiffs filed with the District Director of Internal Revenue in Los Angeles, California, an amended joint Federal income tax return for the taxable year of January 1, 1953 through December 31, 1953. The said amended joint Federal income tax return for the taxable year of 1953 showed a net taxable income of $59,290.08 and a tax due of $28,104.60.

5.

The said sum of $28,104.60 in Federal income tax reported due in plaintiffs' amended return for 1953 for the period January 1, 1953 through December 31, 1953, referred to in Paragraph 4, was paid on or before the dates required by law.

6.

On June 29, 1956, the Commissioner of Internal Revenue issued to plaintiffs a statutory notice of deficiency in Federal income tax asserting a deficiency of $113,684.48 for the year 1953. The entire [3] amount of the asserted deficiency of $113,684.48 resulted from the disallowance of the sum of $143,465.00 which had been claimed as an interest de-

duction by plaintiffs on their joint Federal income tax return for the year 1953.

7.

The disallowance of the sum of $143,465.00 claimed as interest by plaintiffs on their joint Federal income tax return for the year 1953 was explained in the said statutory notice of deficiency as follows:

> "It is held that the amounts aggregating $143,465.00 paid by you on the single-premium 30-year maturity deferred annuity savings bonds issued by the Sam Houston Life Insurance Company and claimed as an interest deduction in your return for the year 1953, are not interest within the meaning of section 23 (b) of the Internal Revenue Code of 1939 and are not deductible for Federal income tax purposes."

A true and correct copy of the statutory notice of deficiency issued to plaintiffs is attached herewith and made a part hereof as Exhibit A.

8.

On July 19, 1956, plaintiffs paid to the District Director of Internal Revenue in Los Angeles, California, the said asserted deficiency of $113,684.48 alleged to be due according to the statutory notice of deficiency of June 29, 1956, attached hereto as Exhibit A. On August 3, 1956, plaintiffs paid to the District Director of Internal Revenue in Los Angeles, California, the sum of $15,795.91 of interest due on the said asserted deficiency of $113,684.48.

9.

Thereafter, on October 8, 1956, plaintiffs filed on a United States Treasury Form 843 a claim for refund in Federal income taxes in the amount of $129,480.39 ($113,684.48 of asserted deficiency and $15,795.91 of interest paid thereon) plus interest, for the taxable period January 1, 1953, through December 31, 1953. A true and correct copy of that claim for refund is attached hereto and made a part hereof as Exhibit B.

10.

A period in excess of six months has elapsed since the claim for refund described in Paragraph 9 was filed, and no action has been taken by the Commissioner of Internal Revenue.

11.

On December 11, 1953, plaintiff Carl F. Knetsch paid interest in the amount of $143,465.00 to the Sam Houston Life Insurance Company.

12.

Plaintiffs are entitled to the deduction of $143,465.00 claimed on their amended joint Federal income tax return filed on March 15, 1954, for the taxable year of 1953.

13.

The failure of the Commissioner to act upon the said claim for refund allowing plaintiffs the deduction claimed for interest in the sum of $143,465.00 is erroneous, illegal, and without warrant in law.

14.

By reason of the facts set forth in this First Count, there is now [5] due and owing from defendant to plaintiffs the sum of $129,480.39 with interest thereon as provided by law. Such sum was erroneously and illegally collected from plaintiffs. Notwithstanding plaintiffs' claim for refund of $129,480.39, no part of the amount has been paid or credited and there are no offsets or credits against the same.

Wherefore, plaintiffs demand judgment against defendant in the sum of $129,480.39 plus interest according to law together with costs.

Second Count

15.

This is an action arising under the Internal Revenue laws of the United States as hereinafter more fully appears. The jurisdiction of this Court is based upon Title 28, Section 1346 (a) (1) of the United States Code, Act of June 25, 1948, c. 646, 62 Stat. 689, 933 as amended by the Act of July 30, 1954, c. 648, sec. 1, 68 Stat. 589.

16.

This action is brought for the recovery of $128,458.02 of income tax collected from plaintiffs for the calendar year of 1954 plus interest thereon at the rate of 6% per annum from the date of payment.

17.

Plaintiffs are now, and at all times hereinafter

mentioned, were residents and citizens of the State of California, County of Los Angeles, District of Southern California.

18.

On or before March 15, 1955, plaintiffs filed with [6] the District Director of Internal Revenue in Los Angeles, California, a joint Federal income tax return for the taxable year of January 1, 1954, through December 31, 1954. The said joint Federal income tax return for the taxable year of 1954 showed a net taxable income of $83,123.78 and a tax due of $40,863.16.

19.

The said sum of $40,863.16 in Federal income tax reported due in plaintiffs' return for 1954 for the period January 1, 1954 through December 31, 1954, referred to in Paragraph 18 was paid on or before the dates required by law.

20.

On June 29, 1956, the Commissioner of Internal Revenue issued to plaintiffs a statutory notice of deficiency in Federal income tax asserting a deficiency of $119,613.20. The entire amount of the asserted deficiency of $119,613.20 resulted from the disallowance of the sum of $147,105.00 which had been claimed as an interest deduction by plaintiffs on their joint Federal income tax return for the year 1954.

21.

The disallowance of the sum of $147,105.00 claimed as interest by plaintiffs on their joint Fed-

eral income tax return for the year 1954 was explained in the said statutory notice of deficiency as follows:

> "It is held that the amounts aggregating $147,105.00 paid by you on the single-premium 30-year maturity deferred annuity savings bonds issued by the Sam Houston Life Insurance Company and claimed as an interest deduction in your [7] return for the year 1954, are not interest within the meaning of section 163 of the Internal Revenue Code of 1954 and are not deductible for Federal income tax purposes."

A true and correct copy of a statutory notice of deficiency issued to plaintiffs is attached herewith and made a part hereof as Exhibit A.

22.

On July 19, 1956, plaintiffs paid to the District Director of Internal Revenue in Los Angeles, California, the said asserted deficiency of $119,613.20 alleged to be due according to the statutory notice of deficiency of June 29, 1956 attached hereto as Exhibit A. On August 3, 1956, plaintiffs paid to the District Director of Internal Revenue in Los Angeles, California, the sum of $8,844.82 of interest due on the said asserted deficiency of $119,613.20.

23.

Thereafter, on October 8, 1956, plaintiffs filed on a United States Treasury Form 843 a claim for refund in Federal income taxes in the amount of

$128,458.02 ($119,613.20 of asserted deficiency and $8,844.82 of interest paid thereon) plus interest, for the taxable period January 1, 1954 through December 31, 1954. A true and correct copy of that claim for refund is attached hereto and made a part hereof as Exhibit C.

24.

A period in excess of six months has elapsed since the claim for refund described in Paragraph 23 was filed, and no action has been taken by the Commissioner of Internal Revenue. [8]

25.

During December of 1954, plaintiff Carl F. Knetsch paid interest totaling $147,105.00 to the Sam Houston Life Insurance Company.

26.

Plaintiffs are entitled to the deduction of $147,105.00 claimed on their joint Federal income tax return filed on or before March 15, 1955, for the taxable year of 1954.

27.

The failure of the Commissioner to act upon the said claim for refund allowing plaintiffs the deduction claimed for interest in the sum of $147,105.00 is erroneous, illegal, and without warrant in law.

28.

By reason of the facts set forth in this Second Count, there is now due and owing from defendant to plaintiffs the sum of $128,458.02 with interest thereon as provided by law. Such sum was erroneously and illegally collected from plaintiffs. Not-

withstanding plaintiffs' claim for refund of $128,458.02, no part of the amount has been paid or credited and there are no offsets or credits against the same.

Wherefore, plaintiffs demand judgment against defendant in the sum of $128,458.02 plus interest according to law together with costs.

McLANE & McLANE,
/s/ By NOLA McLANE,
Attorneys for Plaintiffs. [91]

EXHIBIT "A"

U. S. Treasury Department, Internal Revenue Service, Regional Commissioner, 1250 Subway Terminal Building, 417 South Hill Street, Los Angeles 13, California.

In Reply Refer to Ap:LA:AA-RR (COP) 90-D.

Mr. Karl F. Knetsch and
Mrs. Eva Fay Knetsch
Husband and Wife
3532 West 80th Street
Inglewood, California

Jun 29 1956

Dear Mr. and Mrs. Knetsch:

You are advised that the determination of your income tax liability for the taxable years ended December 31, 1953 and December 31, 1954 discloses an aggregate deficiency of $233,297.68, as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency mentioned.

Exhibit "A"—(Continued)

Within 90 days from the date of the mailing of this letter you may file a petition with The Tax Court of the United States, at its principal address Washington 4, D. C., for a redetermination of the deficiency. In counting the 90 days you may not exclude any day unless the 90th day is a Saturday, Sunday, or legal holiday in the District of Columbia, in which event that day is not counted as the 90th day. Otherwise Saturdays, Sundays and legal holidays are to be counted in computing the 90-day period.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the Assistant Regional Commissioner, Appellate, 1250 Subway Terminal Building, 417 South Hill Street, Los Angeles 13, California. The signing and filing of this form will expedite the closing of your returns by permitting early assessment of the deficiency and will prevent the accumulation of interest, since the interest period terminates 30 days after receipt of the form, or on the date of assessment, or on the date of payment, whichever is the earliest.

Very truly yours,

Russell C. Harrington
Commissioner

By /s/ H. L. Ducker
Associate Chief, Appellate Division

Enclosures:
Statement
IRS Pub. No. 160
Agreement Form [10]

Exhibit "A"—(Continued)

Ap:LA:AA-RR (COP) 90-D

STATEMENT

Mr. Karl F. Knetsch and Mrs. Eva Fay Knetsch Husband and Wife
3532 West 80th Street, Inglewood, California

Tax Liability for the Taxable Years Ended December 31, 1953 and December 31, 1954.

Year		Deficiency
1953	Income Tax	$113,684.48
1954	Income Tax	119,613.20
Total		$233,297.68

In making this determination of your income tax liability careful consideration has been given to the reports of examination dated February 15, 1956 and April 4, 1956, to your protest dated May 17, 1956 and to the statements made at the conference held on June 13, 1956.

Copies of the letter and statement have been mailed to your authorized representative, Mr. W. Lee McLane, Jr., 806 Security Building, Phoenix, Arizona.

Adjustment to Net Income

Year 1953

Net income as disclosed by amended return filed March 15, 1954	$ 59,290.08
Unallowable deduction:	
(a) Interest expense	143,465.00
Net income as adjusted	$202,755.08

Explanation of Adjustment

(a) It is held that the amounts aggregating $143,465.00 paid by you on the single-premium 30-year maturity deferred annuity savings bonds issued by the Sam Houston Life Insurance Company and claimed as an interest deduction in your return for the year 1953, are not interest within the meaning of section 23(b) of the Internal Revenue Code of 1939 and are not deductible for Federal income tax purposes.

Exhibit "A"—(Continued)

Computation of Tax
Year 1953

	Alternative Tax	Tax At Ordinary Rates
Net income	$202,755.08	$202,755.08
Less: Long-term capital gain	325.00	
Ordinary income	$202,430.08	$202,755.08
Less: Exemptions (2)	1,200.00	1,200.00
Amount subject to tax—joint	$201,230.08	$201,555.08
Amount—for single computation	$100,615.04	$100,777.54
Tax—single computation	$ 70,769.54	$ 70,915.79
Tax—joint	$141,539.08	$141,831.58
Add: 52% of $325.00	169.00	
Alternative tax (lesser tax)	$141,708.08	
Tax at ordinary rates (not applicable)		$141,831.58
Tax from above		$141,708.08
Add: Self-employment tax		81.00
Income tax liability		$141,789.08
Income tax per return:		
Original, Account No. AR 1000027, Los Angeles District	$ 28,106.20	
Less: Overassessment allowed, (amended return) ITC 7013	1.60	28,104.60
Deficiency of income tax		$113,684.48

Adjustment to Net Income
Year 1954

Net income as disclosed by return	$ 83,123.78
Unallowable deduction:	
(a) Interest expense	147,105.00
Net income as adjusted	$230,228.78

Explanation of Adjustment

(a) It is held that the amounts aggregating $147,105.00 paid by you on the single-premium 30-year maturity deferred annuity savings bonds issued by the Sam Houston Life Insurance Company and claimed as an interest deduction in your return for

Exhibit "A"—(Continued)

the year 1954, are not interest within the meaning of section 163 of the Internal Revenue Code of 1954 and are not deductible for Federal income tax purposes.

Computation of Tax
Year 1955

	Alternative Tax	Tax At Ordinary Rates
Net income	$230,228.78	$230,228.78
Less: Long-term capital gain	275.00	
Ordinary income	$229,953.78	$230,228.78
Less: Exemptions (2)	1,200.00	1,200.00
Amount subject to tax—joint	$228,753.78	$229,028.78
Amount—for single computation	$114,376.89	$114,514.39
Tax—single computation	$ 80,115.43	$ 80,237.81
Tax—joint	$160,230.86	$160,475.62
Add: 50% of $275.00	137.50	
Alternative tax (lesser tax)	$160,368.36	
Tax at ordinary rates (not applicable)		$160,475.62
Tax from above		$160,368.36
Add: Self-employment tax		108.00
Income tax liability		$160,476.36
Income tax per return: Original, Account No. 273002887 Los Angeles District		40,863.16
Deficiency of income tax		$119,613.20

EXHIBIT "B"

CLAIM

Form 843—Rev. Jan. 1955

Received Oct. 8, 1956, Director Int. Rev. Los Angeles, Teller #3. * * * * *

Name of taxpayer or purchaser of stamps: Karl F. Knetsch and Eva Fay Knetsch.

Number and street: 3532 West 80th Street.

Exhibit "B"—(Continued)

City, town, postal zone, State: Inglewood, California.

1. District in which return (if any) was filed: California (Los Angeles).

2. Name and address shown on return, if different from above: Same.

3. Period: From January 1, 1953, to January 1, 1954.

4. Kind of tax: Income.

5. Amount of assessment: $113,684.48.

Dates of payment: July 19, 1956, plus $15,795.91 of interest pd. 8/3/56.

6. Date stamps were purchased from the Government: .....

7. Amount to be refunded: $129,480.39 plus interest or such greater amount as is legally refundable.

8. Amount to be abated (not applicable to income, estate or gift taxes): .....

9. The claimant believes that this claim should be allowed for the following reasons: See attached pages one (1) through three (3) which are incorporated herewith and made a part hereof.

I declare under the penalties of perjury that this claim (including any accompanying schedules and statements) has been examined by me and to the best of my knowledge and belief is true and correct

Dated Oct. 8, 1956.

/s/ KARL F. KNETSCH.

/s/ EVA FAY KNETSCH. [14]

* * * * *

Exhibit "B"—(Continued)

On December 11, 1953, claimant, Karl F. Knetsch, executed an application to purchase ten single premium deferred annuities from the Sam Houston Life Insurance Company of Houston, Texas, for a consideration of $400,000.00 for each annuity, or a total of $4,000,000.00 for all ten annuities. Along with the application, claimant, Karl F. Knetsch, paid $4,000 by check to the Company as a cash premium. Thereafter, on the same date, December 11, 1953, the Sam Houston Life Insurance Company issued ten annuity contracts for a consideration of the $4,000 and the execution by Karl F. Knetsch of ten contract loan agreements of $400,000 each.

Under the terms of each loan agreement, it was provided that the Company was directed to apply the sum of $400,000.00 in payment of each premium of $400,000.00 remaining due by the claimant.

The ten annuity contracts were issued on December 11, 1953, and claimant, Karl F. Knetsch, paid interest at the rate of 3½% per annum on $4,000,000.00, or $140,000.00, to the Sam Houston Life Insurance Company on December 11, 1953. The said sum of $140,000.00 was paid to the Company by means of a cashier's check.

In addition to the loan of $4,000,000.00, claimant, Karl F. Knetsch, also borrowed $99,000.00 from the Sam Houston Life Insurance Company on December 11, 1953, and paid interest on the $99,000.00 loan at the rate of 3½% per annum, or $3,465.00, to the Company on December 11, 1953.

Exhibit "B"—(Continued)

Thus, claimant paid interest totaling $143,465.00 to the Sam Houston Life Insurance Company on December 11, 1953, which amount was claimed as a deduction on the Federal income tax return of Karl F. Knetsch and Eva Fay Knetsch for the taxable year ending December 31, 1953.

On June 29, 1956, the Commissioner of Internal Revenue issued a statutory notice of deficiency to claimants asserting a deficiency in income taxes of $113,684.48 resulting from the disallowance of the said $143,465.00 interest deduction, on the ground that:

> "(a) It is held that the amounts aggregating $143,465.00 paid by you on the single premium 30-year maturity deferred annuity savings bonds issued by the Sam Houston Life Insurance Company and claimed as an interest deduction in your return for the year 1953, are not interest within the meaning of Section 23 (b) of the Internal Revenue [15] Code of 1939 and are not deductible for Federal income tax purposes."

It is the position of claimants that the $143,465.00 claimed as an interest deduction is allowable as interest within the meaning of the Internal Revenue Code of 1939.

Section 23 (b) of the 1939 Internal Revenue Code provides a deduction for:

> "All interest paid or accrued within the taxable year on indebtedness, * * *"

It should be noted that the above section does

Exhibit "B"—(Continued)

not deal with trade or business expenses. Instead, it is known as one which permits deductions for non-trade or non-business expenses. That is why one of the looseleaf services states that:

> "A deduction without limitation is permitted any taxpayer for all interest paid or accrued on indebtedness."[1]

Therefore, since it is a fact that the $143,465.00 was paid during 1953, the only remaining question is whether it was paid on an indebtedness. Because the claimant, ~~Karl F.~~ Knetsch, executed loan agreements for the respective sums of $4,000,000.00 and $99,000.00, it is clear that indebtedness existed.

This leaves only the issue of whether the sum of $143,465.00 paid in 1953 was interest. "Interest on indebtedness has a definite and well-accepted meaning as compensation allowed by law or fixed by the parties for use, or forbearance, or detention of money."[2] It has also been defined as "compensation for money borrowed or the forbearance of money legally owed."[3] Certainly the phrase "or the forbearance of money legally owed" contemplates that interest comes into existence in cases other than those where money has changed hands. Here the Sam Houston Life Insurance Company agreed that it would apply the $4,000,000.00 loan proceeds in

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[1] 1 CCH Fed. Tax Rep. par. 171.196 (1954).

[2] Fall River Electric Light Co., 23 B.T.A. 168, 171 (1931).

[3] Journal Company v. Comm., 44 B.T.A. 460 1941.

Exhibit "B"—(Continued)

payment of the premiums due on the ten annuity contracts, and received from claimants the sum of $140,000.00 as interest at the rate of 3½% per annum on said sum. In addition, the sum of $99,000.00 was loaned to claimants, upon which $3,465.00 was received by the Company as interest from claimants. [16]

Consequently, it is clear that the Internal Revenue Code of 1939 allows the deduction of $143,465.00 claimed by claimants as interest. Such being the case, it follows that claimants are entitled to a refund of the $129,480.39 plus interest as allowed by law. [17]

EXHIBIT "C"

CLAIM

Form 843—Rev. Jan. 1955

Received Oct. 8, 1956, Director Int. Rev., Los Angeles, Teller #3.

* * * * *

Name of taxpayer or purchaser of stamps: Karl F. Knetsch and Eva Fay Knetsch.

Number and street: 353 West 80th Street.

City, town, postal zone, State: Inglewood, California.

1. District in which return (if any) was filed: California (Los Angeles).

2. Name and address shown on return, if different from above: Same.

3. Period: From January 1, 1954, to January 1, 1955.

4. Kind of tax: Income tax.

Exhibit "C"—(Continued)

5. Amount of assessment: $119,613.20.

Dates of payment: July 19, 1956, plus $8,844.82 of interest paid 8/3/56.

6. Date stamps were purchased from the Government: .....

7. Amount to be refunded: $128,458.02 plus interest or such greater amount as is legally refundable.

8. Amount to be abated (not applicable to income, estate, or gift taxes): .....

9. The claimant believes that this claim should be allowed for the following reasons: See attached pages one (1) through three (3) which are incorporated herewith and made a part hereof.

I declare under the penalties of perjury that this claim (including any accompanying schedules and statements) has been examined by me and to the best of my knowledge and belief is true and correct.

Dated Oct. 8, 1956.

/s/ KARL F. KNETSCH.
/s/ EVA FAY KNETSCH. [18]

* * * * *

On December 11, 1953, claimant, Karl F. Knetsch, executed an application to purchase ten single premium deferred annuities from the Sam Houston Life Insurance Company of Houston, Texas, for a consideration of $400,000.00 for each annuity, or a total of $4,000,000.00 for all ten annuities. Along with the application, claimant, Karl F. Knetsch, paid $4,000.00 by check to the Company as a cash

Exhibit "C"—(Continued)

premium. Thereafter, on the same date, December 11, 1953, the Sam Houston Life Insurance Company issued ten annuity contracts for a consideration of the $4,000 and the execution by Karl F. Knetsch of ten contract loan agreements of $400,000.00 each.

Under the terms of each loan agreement, it was provided that the Company was directed to apply the sum of $400,000.00 in payment of each premium of $400,000.00 remaining due by the claimant. The ten annuity contracts were issued on December 11, 1953.

Interest at the rate of 3½% per annum on the $4,000,000.00 loan was paid in 1953 and 1954 by claimant, Karl F. Knetsch. The interest payment for the year 1954 in the amount of $140,000.00 was paid on December 27, 1954 to the Sam Houston Life Insurance Company. The said sum of $140,000.00 was paid to the Company by means of a cashier's check.

In addition to the loan of $4,000,000.00, claimant, Karl F. Knetsch, also borrowed $203,000.00 from the Sam Houston Life Insurance Company during 1954, and paid interest on the $203,000.00 loan at the rate of 3½% per annum. The interest on the $203,000.00 loan was paid as follows: $3,465.00 to the Company on December 27, 1954, and $3,640.00 to the Company on December 30, 1954.

Thus, claimant paid interest totaling $147,105.00 to the Sam Houston Life Insurance Company in December of 1954, which amount was claimed as a deduction on the Federal income tax return of Karl

Exhibit "C"—(Continued)

F. Knetsch and Eva Fay Knetsch for the taxable year ending December 31, 1954.

On June 29, 1956, the Commissioner of Internal Revenue issued a statutory notice of deficiency to claimants asserting a deficiency in income taxes of $119,613.20 resulting from the disallowance of the said $147,105.00 interest deduction, on the ground that:

> "(a) It is held that the amounts aggregating $147,105.00 paid by you on the single premium 30-year maturity deferred annuity savings bonds issued by the Sam Houston [18] Life Insurance Company and claimed as an interest deduction in your return for the year 1954 are not interest within the meaning of Section 163 of the Internal Revenue Code of 1954 and are not deductible for Federal income tax purposes."

It is the position of claimants that the $147,105.00 claimed as an interest deduction is allowable as interest within the meaning of the Internal Revenue Code of 1954.

Section 163 (a) of the 1954 Internal Revenue Code provides a deduction for:

> "All interest paid or accrued within the taxable year on indebtedness, * * *"

It should be noted that the above section does not deal with trade or business expenses. Instead, it is

Exhibit "C"—(Continued)

known as one which permits deductions for non-trade or non-business expenses. That is why one of the looseleaf services states that:

> "A deduction without limitation is permitted any taxpayer for all interest paid or accrued on indebtedness * * *"[1]

Therefore, since it is a fact that the $147,105.00 was paid during 1954, the only remaining question is whether it was paid on an indebtedness. Because the claimant, Karl F. Knetsch, executed loan agreements for the respective sums of $4,000,000.00 and $203,000.00, it is clear that indebtedness existed.

This leaves only the issue of whether the sum of $147,105.00 paid in 1954 was interest. "Interest on indebtedness has a definite and well-accepted meaning as compensation allowed by law or fixed by the parties for use, or forbearance, or detention of money."[2] It has also been defined as "compensation for money borrowed or the forbearance of money legally owed."[3] Certainly the phrase "or the forbearance of money legally owed" contemplates that interest comes into existence in cases other than those where money has changed hands. Here the Sam Houston Life Insurance Company agreed that it would apply the $4,000,000.00 loan proceeds in

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[1] 1 CCH Fed. Tax Rep. par. 171.196 (1954).

[2] Fall River Electric Light Co., 23 B.T.A. 168, 171 (1931).

[3] Journal Company v. Comm., 44 B.T.A. 460 (1941).

Exhibit "C"—(Continued)

payment of the premiums due on the ten annuity contracts, and received from claimants the sum of $140,000.00 as interest at the rate of 3½% per annum on said sum. In addition, the sum of $203,000.00 was loaned to claimants, upon which $3,465.00 and $3,640.00 was received by the Company as interest from claimants. [19]

The only remaining issue is whether, by virtue of the terms of Section 264 of the 1954 Internal Revenue Code, the interest payment of $147,105.00 is not allowed as a deduction. That section provides that no deduction shall be allowed for

> "(2) Any amount paid or accrued on indebtedness incurred or continued to purchase or carry a single premium life insurance, endowment, or annuity contract.
>
> Paragraph (2) shall apply in respect of annuity contracts only as to contracts purchased after March 1, 1954."

Since the contracts involved herein were all purchased prior to March 1, 1954, it follows that Section 264 is not applicable.

Consequently, it is clear that the Internal Revenue Code of 1954 allows the deduction of $147,105.00 claimed by claimants as interest. Such being the case, it follows that claimants are entitled to a refund of the $128,458.02 plus interest as allowed by law. [20]

[Endorsed]: Filed May 3, 1957.

[Title of District Court and Cause.]

ANSWER

Comes now the defendant in answer to plaintiffs' complaint and admits, denies and alleges as follows:

First Alleged Count

I.

Admits the allegations contained in paragraph 1.

II.

Admits the allegations contained in paragraph 2.

III.

Admits the allegations contained in paragraph 3.

IV.

Admits the allegations contained in paragraph 4.

V.

Admits the allegations contained in paragraph 5.

VI.

Admits the allegations contained in paragraph 6.

VII.

Admits the allegations contained in paragraph 7.

VIII.

Admits the allegations contained in paragraph 8 thereof except that it is denied that the dates of payments were July 19, 1956 and August 3, 1956, respectively. The $113,684.48 was paid July 9, 1956 and the $15,795.91 interest was paid July 27, 1956.

IX.

Admits the allegations contained in paragraph 9

except that each and every allegation contained in the claim for refund, Exhibit B, is denied except as otherwise specifically admitted herein.

X.

Admits the allegations contained in paragraph 10.

XI.

Denies the allegations contained in paragraph 11.

XII.

Denies the allegations contained in paragraph 12.

XIII.

Denies the allegations contained in paragraph 13.

XIV.

Denies the allegations contained in paragraph 14 except that it is admitted that no part of the sum of $129,480.39 has been paid or credited.

Second Alleged Count

XV.

Admits the allegations contained in paragraph 15.

XVI.

Admits the allegations contained in paragraph 16.

XVII.

Admits the allegations contained in paragraph 17.

XVIII.

Admits the allegations contained in paragraph 18.

XIX.

Admits the allegations contained in paragraph 19.

XX.

Admits the allegations contained in paragraph 20.

XXI.

Admits the allegations contained in paragraph 21.

XXII.

Admits the allegations contained in paragraph 22 except that the dates of payment of July 19, 1956 and August 3, 1956 are denied. The payment of $119,613.20 was made July 9, 1956. The payment of $8,844.82 was made July 27, 1956.

XXIII.

Admits the allegations contained in paragraph 23 except that each and every allegation contained in the claim for refund, Exhibit C, is denied except as it is otherwise specifically admitted herein.

XXIV.

Admits the allegations contained in paragraph 24.

XXV.

Denies the allegations contained in paragraph 25.

XXVI.

Denies the allegations contained in paragraph 26.

XXVII.

Denies the allegations contained in paragraph 27.

XXVIII.

Denies the allegations contained in paragraph 28 except that it is admitted that no part of said sum of $128,458.02 has been paid or credited.

Wherefore, defendant prays that the action be dismissed with prejudice, that judgment be entered that plaintiffs take nothing and that defendant have its costs in its behalf expended. [23]

LAUGHLIN E. WATERS,
United States Attorney,
EDWARD R. McHALE,
Assistant United States Attorney, Chief, Tax Division,
ROBERT H. WYSHAK,
Assistant United States Attorney,
/s/ EDWARD R. McHALE,
Attorneys for Defendant. [24]

Affidavit of Service by Mail Attached. [25]

[Endorsed]: Filed July 3, 1957.

[Title of District Court and Cause.]

PLAINTIFFS' MEMORANDUM IN SUPPORT OF PLAINTIFFS' OBJECTIONS TO EXHIBITS 53-61

Memorandum

Defendant proposes to offer the year end financial statements of the Sam Houston Life Insurance Company (Exhibits 53-58), a Wall Street Journal advertisement placed by the company (Exhibit 59), a letter mailed to defendant's counsel on September 17, 1957, by the company (Exhibit 60), and a summary of annuity contracts issued by the company

in 1953 and 1954 (Exhibit 61). Since plaintiffs submit that the only factual and legal issue is whether or not plaintiffs became indebted to the Sam Houston Life Insurance Company, it follows that such evidence is not [37] relevant as to this issue.

In determining a dispute regarding the relevancy of proffered evidence, the question to be resolved, says Jones on Evidence,[1] "is as to whether there is a logical or rational connection between the fact which is sought to be proved and a matter of fact which has been made an issue in the case."

Applying this test to the financial statements of the Sam Houston Life Insurance Company (Exhibits 53-58) it is submitted that there is no logical or rational connection between the year end financial condition of the company or the percentage of its reserves set aside for issued annuity contracts and the issues of whether Knetsch was indebted to the company. A creditor need not be solvent at the end of a taxable year in order to qualify as a creditor. Nor is a debtor any the less or more of a debtor depending upon the solvency of the lender.

In fairness it should be pointed out that undoubtedly the defendant's offer of Exhibits 53-58 is connected with the defendant's contention that plaintiffs did not borrow money from the company and hence there could be no indebtedness. However, this view has been presented to the courts in the past and been rejected. For instance, in Northwestern Pennsylvania Gas Corp., 3 TCM 52, Prentice-Hall 1944 TC Mem. Dec. par. 44,017 at 65,

[1] Jones on Evidence § 137, p. 238 (1938).

the Tax Court, citing a Supreme Court decision, said:

> "Respondent's position, we think, is wholly untenable. The indebtedness upon which interest may be deducted is not limited to money borrowed: Deputy v. du Pont, 308 U. S. 488."

Therefore, the cash position of the company at the beginning and end of each year is not significant. Furthermore, even if the rule respecting indebtedness [38] did require that actual money be borrowed before the kind of indebtedness arose upon which interest could be deducted, the company's balance of cash accounts at the beginning and end of each year would not constitute relevant evidence of the amount of company cash on hand on or about December 11, 1953, which was the day Knetsch executed the contract loan agreements totaling $4,000,000.00.

Exhibit 59-60

This advertisement which appeared in the Wall Street Journal after placement there by the company is offered, according to defendant's statement at the July 7, 1958, pre-trial conference, to show that Knetsch's intent in purchasing the annuities and executing the contract loan agreements was not to create indebtedness but simply to avoid tax liability.

Invoking the same tests set forth above, it is submitted that the company placed the advertisement. Knetsch did not. Therefore, Knetsch's intent cannot be determined from this fact. Furthermore, while the intent of the parties to create indebt-

edness may be a proper factual issue, it does not follow that ascertaining the intent of only one of the parties reflects the intent of both parties.

The same considerations apply with respect to the envelope addressed to defendant's counsel. While it is stated as fact in paragraph 22 of the proposed Pre-Trial Conference Order that literature such as Exhibit 60 was sent to Knetsch and received by him after inquiries made by him, it is submitted that there is no rational connection between this fact and the issue of whether Knetsch subsequently became indebted to the company in 1953 and 1954. [39]

Exhibit 61

This summary of the single premium annuities issued by the Sam Houston Life Insurance Company has no rational or logical connection with the issue of whether Knetsch was indebted to the company in 1953 and 1954. The volume of annuities sold, whether large or small, is not relevant to the issue of indebtedness.

Summary

All of the exhibits from 53 through 61, are not, it is submitted, relevant to the issue of whether Knetsch became indebted to the company in 1953 and 1954.

Respectfully submitted,

/s/ NOLA McLANE,
Attorney for Plaintiffs.

[Endorsed]: Filed July 16, 1958.

PLAINTIFFS' EXHIBIT No. 71

[Title of District Court and Cause.]

(For Identification)

PRE-TRIAL CONFERENCE ORDER

Following pre-trial proceedings pursuant to Rule 16 of the Federal Rules of Civil Procedure and Local Rule 9 of this Court, it is ordered:

I.

This is an action seeking a refund of Federal income tax paid by plaintiffs for the years 1953 and 1954. Karl F. Knetsch and his wife, Eva Fay Knetsch, are the plaintiffs, while the United States of America is the defendant. The complaint and answer raise the issues.

II.

Federal jurisdiction is invoked under Title 28, Section 1346(a)(1) of the United States Code, Act of June 25, 1948, c. 646, 62 Stat. 689, 933 as amended by the Act of July 30, 1954, c. 648, sec. 1, 68 Stat. 589, and Section 1340.

III.

The exhibits to be offered at the trial, or a photo [41] reproduction thereof, are as follows and they may be introduced into evidence without any foundation being laid or evidence of authenticity introduced and without prejudice to the right of either party to object to the competency, materiality, or relevancy thereof:

Ex. 1: Application for an annuity to the Sam

Plaintiffs' Exhibit No. 71—(Continued)

Houston Life Insurance Company, Houston, Texas, by plaintiff Karl F. Knetsch (hereinafter referred to as Knetsch).

Ex. 2: Check dated December 11, 1953, for $4,000.00.

Ex. 3-12: Sam Houston Life Insurance Company Annuity Savings Bonds issued to Karl F. Knetsch, numbered A-15400 through A-15409, respectively.

Ex. 13-22: Annuity Loan Notes and Assignments by Knetsch, dated December 11, 1953, one for each bond numbered A-15400 through A-15409, respectively.

Ex. 23: Cashier's check dated December 11, 1953, for $140,000.00.

Ex. 24: Typed receipt of Sam Houston Life Insurance Company dated December 11, 1953, for $140,000.00.

Ex. 25: Cashier's check dated December 16, 1953, for $99,000.00.

Ex. 26-35: Annuity Loan Notes and Assignment dated December 16, 1953, each in the sum of $9,900, one for each bond numbered A-15400 through A-15409, respectively.

Ex. 36: Check dated December 16, 1953, for $3,465.

Ex. 37: Typed receipt of Sam Houston Life Insurance Company dated December 16, 1953, for $3,465.

Ex. 38-47: Annuity Loan Notes and Assignments each in the sum of $20,300 dated December 30, 1954,

Plaintiffs' Exhibit No. 71—(Continued)

one for each bond numbered A-15400 through A-15409, respectively. [42]

Ex. 48: Cashier's check dated December 30, 1954, for $104,000.00.

Ex. 49: Cashier's check dated December 27, 1954, for $143,465.00.

Ex. 50: Check dated December 30, 1954, for $3,640.

Ex. 51: Sam Houston Life Insurance Company receipt dated December 30, 1954, for $7,105.

Ex. 52: Sam Houston Life Insurance Company receipt dated December 30, 1954, for $140,000.00.

Ex. 53-58: Excerpts from Best's Life Insurance Reports regarding Sam Houston Life Insurance Company for calendar years 1952 through 1956, respectively.

Plaintiffs object to Exhibits 53 through 58 upon the ground that they are neither relevant nor material to the issue before the Court which is whether or not plaintiffs paid interest in the sums of $143,465.00 and $147,105.00 to the Sam Houston Life Insurance Company during 1953 and 1954 respectively.

Ex. 59: Wall Street Journal advertisements placed by the Sam Houston Life Insurance Company in the Wall Street Journal.

Plaintiffs object to Exhibit 59 upon the same grounds as set forth in their objections to Exhibits 53 through 58.

Ex. 60: Envelope postmarked September 17,

Plaintiffs' Exhibit No. 71—(Continued)

1957, addressed to Robert B. Wyshak, together with enclosures. [43]

Plaintiffs object to Exhibit 60 upon the same grounds as set forth in their objection to Exhibits 53 through 58.

Ex. 61: Summary of annuity savings bonds sold by Sam Houston during 1953 and 1954.

Plaintiffs object to Exhibit 61 upon the same grounds as set forth in their objections to Exhibits 53 through 58.

Ex. 62: Letter of July 25, 1952, from Mr. Salley to E. I. McLarney.

Defendant objects to Exhibit 62 upon the ground that it is irrelevant and immaterial.

Ex. 63: Letter of August 1, 1952, from Treasury Department to Mr. Salley.

Defendant objects to Exhibit 63 upon the ground that it is irrelevant and immaterial.

Ex. 64: Letter from Texas Board of Insurance Commissioner dated September 29, 1953.

Defendant objects to Exhibit 64 upon the ground that it is irrelevant and immaterial.

Ex. 65: Ledger sheet from books and records of Sam Houston Life Insurance Company reflecting the opening, continuation, and closing of the annuity transactions between plaintiffs and the Company.

Defendant objects to Exhibit 65 upon the ground that it contains the conclusions of the [44] Sam Houston Life Insurance Company.

Ex. 66: Examination report of the State of

Plaintiffs' Exhibit No. 71—(Continued)

Texas Insurance Department covering the Sam Houston Life Insurance Company's activities from May 31, 1951, through December 31, 1953.

Defendant objects to Exhibit 66 upon the ground that it is irrelevant, immaterial, and incompetent, not the best evidence, and contains opinion evidence.

Ex. 67-68: Records of Sam Houston Life Insurance Company reflecting types and numbers of policies in force at the end of 1953 and 1954, respectively.

Defendant objects to Exhibits 67 and 68 upon the ground that they are irrelevant and immaterial.

Ex. 69-70: The 1955 and 1956 Federal income tax returns filed by plaintiffs, respectively.

Defendant objects to Exhibits 69 and 70 upon the ground that they are irrelevant and immaterial.

IV.

The following facts are admitted and require no proof:

(1) The plaintiffs are, and were at all times pertinent hereto, husband and wife.

(2) Plaintiffs' method of accounting, for purposes of reporting their 1953 and 1954 income on their Federal income tax returns, was on the cash basis.

(3) The following amounts were paid by the plaintiffs to the District Director of Internal Revenue [45] pursuant to deficiency assessments for the periods there set forth on the following dates:

Plaintiffs' Exhibit No. 71—(Continued)

Year 1953		Date Paid
Tax	$113,684.48	July 9, 1956
Int.	15,795.91	July 27, 1956
Year 1954		
Tax	$119,613.20	July 9, 1956
Int.	8,844.82	July 27, 1956

(4) On or about December 11, 1953, Knetsch delivered Exhibit 1 (entitled "Application for an Annuity") and Exhibit 2 (Knetsch's check in the sum of $4,000.00 payable to the Sam Houston Life Insurance Company (hereinafter referred to as the Company).

(5) Thereafter the company issued to the plaintiff Knetsch Exhibits 3 through 12, the Annuity Savings Bonds, in exchange for the said $4,000 check and the execution and delivery by Knetsch of Exhibits 13 through 22, the Annuity Loan Notes.

(6) Thereupon, Knetsch delivered to the company a check for $140,000.00; Exhibit 23, an amount equal to 3½% of the total principal amount ($4,000,000.00) of the Annuity Loan Notes. Thereupon the company delivered its receipt, Exhibit 24, to Knetsch.

(7) On or about December 16, 1953, the company delivered to Knetsch a check for $99,000 (Exhibit 25).

(8) At or about the same time Knetsch executed and delivered to the company Exhibits 26 through 35, Annuity Loan Notes.

(9) At or about the time of the receipt of the [46] $99,000 by Knetsch from the company, Knetsch

Plaintiffs' Exhibit No. 71—(Continued)

delivered to the company a check for $3,465, Exhibit 36, a sum equal to 3½% of $99,000.

(10) Upon receipt of said check for $3,465, the company issued to the plaintiff its receipt, Exhibit 37.

(11) On or about December 30, 1954, but prior to the expiration of 1954, Knetsch executed and delivered 10 new Annuity Loan Notes, Exhibits 38 through 47 upon receipt from the company of Exhibits 26 through 35, each of the latter being marked "cancelled".

(12) After delivery to the company of Exhibits 38 through 47, the company delivered on December 30, 1954, to the plaintiff a check for $104,000, Exhibit 48.

(13) Concurrently with the receipt by the plaintiff of the said $104,000, plaintiff delivered to the company on December 30, 1954, a cashier's check for $143,465.00, Exhibit 49, and another check for $3,640, Exhibit 50.

(14) On December 30, 1954, and upon the receipt of the two checks, Exhibits 49 and 50, the company delivered to Knetsch Exhibit 51 and Exhibit 52.

(15) The plaintiffs claimed a deduction as interest paid for the $140,000 and the $3,465 paid to Sam Houston during 1953 on their 1953 Federal income tax return, and the $143,465 and the $3,640 paid to Sam Houston during 1954 on their 1954 Federal income tax return. It was these amounts totaling $143,465.00 for 1953 and $147,105.00 for 1954 which were disallowed by the Commissioner of [47] Internal Revenue.

Plaintiffs' Exhibit No. 71—(Continued)

(16) Sam Houston entered on its books the aforementioned amounts of $143,465.00 and $147,105.00 received from Knetsch as interest and also reported the two said sums as part of its gross income in its 1953 and 1954 Federal income tax returns filed with the Internal Revenue Service. In said 1953 and 1954 returns, in accordance with the applicable laws and regulations, the company included the 2½% annual increase in cash value on said bonds as a deduction.

(17) On December 28, 1955, Knetsch executed and delivered new annuity loan notes comparable to those executed in 1953 and 1954 totalling $307,000, and paid the company $150,745.00, while receiving, at the same time, the company's check for $104,000.00 and Exhibits 38 through 47 marked "cancelled."

(18) On their 1955 joint Federal income tax return, Exhibit 70, plaintiffs claimed a deduction for interest paid in the sum of $150,745.00 representing the $150,745.00 referred to in paragraph 17 hereof.

(19) On December 27, 1956, Knetsch surrendered the ten Annuity Savings Bonds (Exhibits 3 through 12) and received therefor a check for $1,000.00 and a cancellation of his alleged indebtedness at that time of $4,307,000.00. Upon said surrender Knetsch received from the company the Annuity Loan Notes, Exhibits 13 through 22, and the ten Annuity Loan Notes, referred to in paragraph 17 hereof, the latter totalling $307,000.00 [48] which had been delivered to the company on December 28, 1955. The

Plaintiffs' Exhibit No. 71—(Continued)

said Annuity Loan Notes, referred to in the preceding sentence, were marked 'cancelled.'"

(20) On their 1956 joint Federal income tax return, plaintiffs reported the sum of $6,074.58 as their net taxable income. In computing the aforesaid reported net taxable income of $6,074.58 plaintiffs first claimed a deduction, under the claimed authority of Section 165, Internal Revenue Code of 1954, in the sum of $138,315.00 as a loss from the surrender of the ten Annuity Savings Bonds. Plaintiffs computed the claimed deduction as follows:

Interest deducted on returns:		
1953	$143,465	
1954	147,105	
1955	150,745	
	$441,315	
Cash paid at time of purchase	4,000	
	$445,315	
Less:		
Amounts received from company		
1953	$ 99,000	
1954	104,000	
1955	104,000	
	$307,000	$138,315

Plaintiffs' computation, as shown above, was in

Plaintiffs' Exhibit No. 71—(Continued)

error in that the $1,000 received upon surrender of the bonds was not taken into account.

(21) Had Knetsch continued to hold said ten Annuity Savings Bonds to maturity when they would have [49] had a guaranteed cash value of *$8,388.000*, and continued to execute annuity loan notes and assignments each year for the total net cash value minus $1,000, he would have received on maturity an annuity of $43 per month. At that time he would have been 90 years old.

(22) Literature comparable to Exhibit 60, but referring to single premium annuities, rather than several pay annuities, was sent in answer to inquiries during 1953 and 1954, by the company. Knetsch received such comparable literature.

(23) The figures and information published by Best's Reports, Exhibits 53 through 58, are in substance true and accurate.

(24) The cash value of the bonds, and the reserve used by the company, increased each year at the rate of 2½% of the amount allegedly owed on each bond.

(25) Over 99% of the reserve carried by the company on its books for annuities for the years 1952, 1953 and 1954 was for 30-year single premium deferred annuity savings bonds.

(26) During the years 1953 and 1954 Sam Houston employed approximately 75 insurance salesmen.

(27) During the years 1953 and 1954, Sam Houston sold 20-year term life insurance, ordinary life insurance, annual renewable term policies, 20-pay-

Plaintiffs' Exhibit No. 71—(Continued)

ment life insurance policies, and some annuities to members of the armed forces.

(28) The Sam Houston Life Insurance Company is a corporation domiciled in the State of Texas.

(29) The policy loans made by the company and set [50] forth on its balance sheets were in large part on annuity savings bonds, such as those purchased by Knetsch.

(30) The annuity bond, referred to in Exhibit 62, is similar to the annuity bonds which were issued to Knetsch. The only difference was that the annuity contract, referred to in Exhibit 62, which was submitted to the U. S. Internal Revenue Service along with Exhibit 62, was a participating contract whereas the annuity bonds issued to Knetsch were not.

(31) The form of the bond issued to Knetsch had been submitted to the Texas Board of Insurance Commissioners prior to September 29, 1953.

(32) Antedating life insurance and annuity contracts is common practice by insurance companies.

V.

The reservations as to the facts cited in paragraph IV above are as follows:

(1) Plaintiffs object to paragraph 22 on the grounds that the fact is neither relevant nor material to the issue of whether plaintiffs paid interest in the sums of $143,456.00 and $147,105.00 to the company in 1953 and 1954 respectively.

(2) Defendant objects to paragraphs 16, 17, 18,

Plaintiffs' Exhibit No. 71—(Continued)

the last two sentences of 19, 20, 26, 27, 28, 30, 31 and 32, upon the ground that they are irrelevant and immaterial.

VI.

There are no unadmitted facts which will be contested at the trial. [51]

VII.

The following issues of fact, and no others, remain to be litigated upon the trial:

(1) Whether Knetsch did not intend to become indebted to the company.

(2) Whether Knetsch did not become indebted to the company during 1953 and 1954.

(3) Whether the sums of $99,000 in 1953 and $104,000 in 1954, received by Knetsch from the company, reduce the deductions found by this Court, if any, for payments made by Knetsch to the company in those years.

(4) Whether Knetsch's transaction with the company had economic substance insofar as he was concerned.

VIII.

The following issues of law, and no others, remain to be litigated upon the trial:

(1) Whether issues of fact 1, 3, and 4, are issues for the Court's determination.

(2) Whether the 1953 payment of $140,000 did or did not constitute interest within the meaning of Section 23(b), Internal Revenue Code of 1939.

Plaintiffs' Exhibit No. 71—(Continued)

(3) Whether said $140,000 was deductible in the year 1953, or in some other year.

(4) Whether the 1953 payment of $3,465 did or did not constitute interest within the meaning of Section 23(b) of Internal Revenue Code of 1939.

(5) Whether said $3,465 was deductible in the [52] year 1953, or in some other year.

(6) Whether the 1954 payment of $143,465 did or did not constitute interest within the meaning of Section 163, Internal Revenue Code of 1954.

(7) Whether said $143,465 was deductible in the year 1954, or in some other year.

(8) Whether the 1954 payment of $3,640 did or did not constitute interest within the meaning of Section 163, Internal Revenue Code of 1954.

(9) Whether said $3,640 was deductible in the year 1954, or in some other year.

(10) Whether the increase in cash value each year on said bonds was includible in Knetsch's income each year.

(11) Whether the sums of $99,000 in 1953 and $104,000 in 1954, received by Knetsch from the company, reduce the deductions found by this Court, if any, for payments made by Knetsch to the company in those years.

(12) Whether Knetsch's transaction with the company had economic substance insofar as he was concerned.

(13) Whether Exhibits 53 through 64, and 66 through 70, are irrelevant and immaterial.

(14) Whether paragraphs 16, 17, 18, the last two

Plaintiffs' Exhibit No. 71—(Continued)

sentences of 19, 20, 22, 26, 27, 28, 30, 31, and 32, are irrelevant and immaterial.

IX.

The foregoing admissions having been made by the parties, [53] and the parties having specified the foregoing issues of fact and law remaining to be litigated, this order shall supplement the pleadings and govern the course of the trial of this cause, unless modified to prevent manifest injustice.

July 21, 1958.

/s/ WM. C. MATHES,
United States District Judge.

Approved as to Form and Content:

McLANE & McLANE,
/s/ By NOLA McLANE,
Attorneys for Plaintiffs.

LAUGHLIN E. WATERS,
United States Attorney,

EDWARD R. McHALE,
Assistant U. S. Attorney,
Chief, Tax Division,

ROBERT H. WYSHAK,
Assistant U. S. Attorney,

/s/ ROBERT H. WYSHAK,
Attorneys for Defendant. [54]

[Endorsed]: Filed July 22, 1958.

[Title of District Court and Cause.]

MINUTES OF THE COURT

Date: Aug. 4, 1958, at Los Angeles, Calif.

Present: Hon. Wm. C. Mathes, District Judge. (calling calendar of Hon. Wm. M. Byrne).

Deputy Clerk: Chas E. Jones; Reporter: Don P. Cram.

Counsel for Plaintiffs: W. Lee McLane and Nola McLane. Counsel for Defendant: Robert H. Wyshak, Assistant U. S. Attorney.

Proceedings: For trial.

Attorney Nola McLane moves to admit Attorney W. Lee McLane to appear in this case only, and Court grants said motion.

Plfs' Ex. 1 to 52 incl. are marked for ident. and admitted in evidence.

Plfs' Ex. 53 to 70 incl. are marked for ident.

It Is Ordered that cause is continued to 10 a.m., Aug. 5, 1958, for further trial.

JOHN A. CHILDRESS,
Clerk,
/s/ By CHARLES E. JONES,
Deputy Clerk. [55]

[Title of District Court and Cause.]

MINUTES OF THE COURT

Date: Aug. 5, 1958, at Los Angeles, Calif.

Present: Hon. Wm. C. Mathes, District Judge.

Deputy Clerk: Chas. E. Jones. Reporter: Don P. Cram.

Counsel for Plaintiff: W. Lee McLane, Jr. Counsel for Defendant: Robert H. Wyshak, Assistant U. S. Attorney.

Proceedings: For further Court trial.

Plf's Ex. 53 to 61 incl. are marked for ident. and admitted in evidence.

Plf's Ex. 62 and 63 are marked for ident. only.

Plf's Ex. 64 to 70 incl. are marked for ident. and admitted in evidence.

Plf's Ex. 71 is marked for ident. only.

Court orders that briefs be filed, plaintiff to file opening brief in thirty days, defendant to file answering brief twenty days thereafter, and plaintiff to file closing brief fifteen days after filing of defendant's answering brief.

It Is Ordered that case is continued to 2 p.m. Oct. 20, 1958, for further trial. (Oral argument.)

JOHN A. CHILDRESS,
Clerk,
/s/ By CHARLES E. JONES,
Deputy Clerk. [156]

[Title of District Court and Cause.]

MINUTES OF THE COURT

Date: Oct. 20, 1958, at Los Angeles, Calif.

Present: Hon. Wm. C. Mathes, District Judge.

Deputy Clerk: Chas. E. Jones; Reporter: Don P. Cram.

Counsel for Plaintiff: W. Lee McLane, Jr. Counsel for Defendant: Robert H. Wyshak, Assistant U. S. Attorney.

Proceedings: For further Court trial (oral argument).

Both sides argue.

Court finds in favor of defendant and against plaintiff.

Counsel for defendant to prepare judgment.

JOHN A. CHILDRESS,
Clerk,
/s/ By CHARLES E. JONES,
Deputy Clerk. [163]

[Title of District Court and Cause.]

PLAINTIFFS' OBJECTIONS TO DEFENDANT'S PROPOSED FINDINGS OF FACT AND CONCLUSIONS OF LAW

The Findings of Fact and Conclusions of Law having been submitted by defendant, plaintiffs set forth the following objections thereto.

Findings of Fact

I-II. No objection. [164]

III. No objection except with respect to the fourth and final sentences thereof. The fourth sentence is objected to for the reason that it is too general and vague, and is not supported by the record. The final sentence is objected to for the reason that it indicates plaintiff Knetsch did not have the use of $1,000,000 which finding is not supported by the record.

IV. Objection is made here for the reason that

the evidence upon which the finding is based was not relevant to the issue of whether plaintiffs were indebted to Sam Houston.

V-VI. No objection.

VII. Objection is made for the reason that this finding is not supported by the evidence.

VIII. Objection is made for the reasons that this finding is (1) not supported by the evidence and (2) is not relevant to a determination of whether or not indebtedness exists.

IX. Objection is made for the reasons that the finding is (1) not supported by the evidence (2) is not relevant to a determination of whether or not indebtedness exists, (3) is contradicted by paragraph 21 of IV of the Pre-Trial Conference Order which stated that had Knetsch continued to execute annuity loan notes for the total net cash value minus $1,000 each year he would receive on maturity an annuity of $43 per month, (4) it contradicts the computation agreed to between the Government and the taxpayer in United States v. Bond, ..F. 2d .., (5th Cir. 1958), [165] concerning the same annuity contracts issued by Sam Houston, which reflect that at the end of ten years the contract accumulations exceed the interest payment, see United States v. Bond, supra, at footnote 13, and (5) it ignores the economic gain to be achieved by the ownership of such annuity contracts during periods of deflation when 2 and ¾% return is greater than the then prevailing interest rates.

X. No objection.

XI. Objection is made to this finding for the

reasons that it (1) indicates an annuity with payments certain is not an annuity within the meaning of Section 24(a)(6), Internal Revenue Code of 1939 and Section 264, Internal Revenue Code of 1954, (2) indicates that the beneficiary has a right to obtain the net cash value of the annuities prior to maturity, and (3) constitutes a conclusion of law rather than of fact.

XII. Objection is made to the phrase "alleged loans" for the reason that there is no evidence in the record to support a finding that loans did not exist, and because the type of security or lack of it does not bear on the issue of whether indebtedness existed. Also objection is made to the second sentence for the reason that the term "whatever" is too broad and the sentence is a conclusion of law rather than of fact.

XIII. Objection is made to this finding for the reasons that (1) it is not supported by the evidence, and (2) is not relevant to the issue of whether indebtedness existed.

XIV. Objection is made to this finding for the reasons that (1) it [166] is not supported by the evidence and (2) is not relevant to the issue of whether indebtedness existed.

XV. Objection is made to this finding for the reasons that (1) it is not supported by the evidence, and (2) is a conclusion of law rather than a finding of fact.

XVI. Objection is made to this finding for the reason that it is not supported by the evidence.

XVII. Objection is made to this finding for the

same reasons set forth in IX hereof, and because the receipt of money is not a pre-requisite to the existence of indebtedness within the meaning of Section 23(b), Internal Revenue Code of 1939 and Section 163, Internal Revenue Code of 1954.

XVIII. Objection is made to this finding for the reasons that (1) it is not supported by the evidence, and (2) is a conclusion of law rather than a finding of fact.

XIX. Objection is made to this finding for the reason that (1) it is not supported by the evidence, and (2) is not relevant to the issue of whether plaintiff Knetsch was indebted to Sam Houston.

Conclusions of Law

I. No objection.

II. Objection is made to the conclusion for the reasons that (1) it [167] is not necessary either under Sections 23(b) of the 1939 Internal Revenue Code or Section 163 of the 1954 Internal Revenue Code that a tax payer enter into a transaction for profit before an interest deduction is permitted (See reasons set forth in plaintiffs' briefs herein), (2) the conclusion is not supported by the evidence herein, and (3) the statement is a finding of fact rather than a conclusion of law.

III. Objection is made to this conclusion for the reasons that (1) it is without support in the evidence, and (2) it does not find support in either

the 1939 or 1954 Internal Revenue Codes or the case law.

IV. Objection is made to this conclusion for the reasons that (1) the fact that a loan is secured upon the sole recourse of the asset sold does not mean there is no indebtedness, and (2) the conclusion is not relevant to the issue of whether indebtedness existed.

V. Objection is made to this conclusion for the reasons that (1) "commercial" substance is not a pre-requisite to the allowance of an interest deduction under either Section 23(b) of the 1939 Internal Revenue Code or Section 163 of the 1954 Internal Revenue Code, (2) is a misstatement or misapplication of the "substance over form" rule, and (3) is without support in law.

VI. Objection is made to this conclusion for the reasons that (1) neither money nor an economic benefit is a pre-requisite to the allowance of an interest deduction under either Section 23(b) of the 1939 Internal Revenue Code or Section 163 of the 1954 Internal Revenue Code; (2) it is not supported by the evidence herein, (3) is without [168] support in law and (4) constitutes a finding of fact rather than a conclusion of law.

VII. Objection is made to this conclusion for the reasons that (1) it is not supported by the evidence, (2) is without support in law, and (3) is a misapplication of the "substance over form" rule.

VIII. Objection is made to this conclusion for

the reasons that (1) it is not supported by the evidence, and (2) is without support in law.

IX. Objection is made to this conclusion for the reason that it ignores the relationship between Section 23(b) and 24(a)(6) of the 1939 Internal Revenue Code and the language of the Committee reports referred to in plaintiffs' briefs herein.

X. Objection is made to this conclusion for the reason that it is not supported by the evidence or the applicable law.

In addition to the foregoing objections to defendant's findings of fact and conclusions of law, plaintiffs also set forth as their reasons the contentions found in their opening and reply brief. Also it is pointed out that defendant's conclusions of law Nos. II, III, IV, V and VI are virtually verbatim copies of defendant's findings of fact Nos. VIII, XV, XII, XIII and XVII.

Respectfully submitted,

McLANE & McLANE,
/s/ By NOLA McLANE,
Attorneys for Plaintiffs. [169]

[Endorsed]: Filed November 4, 1958.

United States District Court, Southern District of California, Central Division

No. 577-57 WM Civil

KARL F. KNETSCH and EVA FAY KNETSCH,
Plaintiffs,

vs.

UNITED STATES OF AMERICA,
Defendant.

FINDINGS OF FACT, CONCLUSIONS LAW, AND JUDGMENT

The above-entitled matter having regularly come on for trial on August 4, 1958 before the Hon. Wm. C. Mathes, United States District Judge, presiding without a jury, the plaintiffs represented by their attorneys, McLane and McLane, by W. Lee McLane, Jr., and the defendant by its attorneys, Laughlin E. Waters, United States Attorney, Southern District of California, Edward R. McHale, Assistant United States Attorney, Chief, Tax Division, and Robert H. Wyshak, Assistant United States Attorney, and the Court having considered the stipulations of fact, documentary evidence, and arguments both oral and written of counsel, makes its findings of fact and conclusions of law as follows:

Findings of Fact

I.

The plaintiffs are husband and wife residing in the City and County of Los Angeles, State of California. [170]

II.

This is an action for recovery of federal individual income taxes paid by the plaintiffs for the years 1953 and 1954, on the ground that they are entitled to certain interest deductions.

III.

On December 11, 1953, the plaintiff Karl F. Knetsch (hereinafter referred to as the plaintiff), purchased 10 annuity savings bonds, from the Sam Houston Life Insurance Company, of Houston, Texas (hereinafter referred to as Sam Houston). At the same time, the plaintiff gave Sam Houston a check for $4,000 and executed 10 "annuity loan notes and assignments of annuity savings bonds." Each of these notes was in the sum of $400,000. The bonds provided that the interest rate on a loan note would be at the rate of 3½% per annum payable in advance. The bonds and notes referred to each other and were intended to be and were integrated documents. Each bond recited that it was in "consideration of the payment in advance of a single premium of $400 in cash, and the execution of a contract loan agreement for $400,000." The annuity loan notes provided that the alleged loans were to be applied to any unpaid premiums. Plaintiff did not receive $4,000,000 from Sam Houston for any purpose.

IV.

Prior to the purchase of these 10 bonds, the plaintiff had been solicited by direct mail advertising from Sam Houston, which recited that a substantial

tax saving could be achieved by the purchase of such bonds. In addition, Sam Houston had so advertised in financial newspapers with regularity.

V.

On December 11, 1953, plaintiff paid Sam Houston $140,000. [171] Shortly thereafter, Sam Houston returned to Knetsch $99,000 and at the same time he executed 10 additional annuity loan notes for $9,900 each. The plaintiff then paid Sam Houston an additional $3,465 during 1953, 3½% of $99,000.

VI.

On December 27, 1954, plaintiff paid Sam Houston $143,465, and received in return from the company a check for $104,000. The 10 annuity loan notes totalling $99,000 were cancelled and 10 new ones were executed by him on December 30, 1954 in the sum of $20,300 each. The plaintiff then paid Sam Houston an additional $3,640, 3½% of $104,000.

VII.

Plaintiff's only motive in purchasing these 10 bonds was to attempt to secure an interest deduction.

VIII.

Plaintiff did not enter into a transaction for profit in the purchase of these bonds.

IX.

The bonds called for annual interest at the rate of 3½% per annum and the increase in cash value

was at the rate of 2½% per annum, compounded annually. No economic gain could be achieved from the purchase of these bonds without regard to the tax consequences, taking into consideration and compounding the loss of income on the payments made to the company.

X.

Plaintiff was sixty years old at the time he purchased these bonds. Although the bonds are described therein as a [172] thirty-year deferred annuity having an "original maturity date" when plaintiff became ninety, the plaintiff could elect to accelerate maturity at any time.

XI.

These bonds contained no insurance element whatever.

XII.

The sole security for the alleged loans according to the terms of the instruments executed by the plaintiff was the 10 annuity savings bonds. There was no personal liability whatever on the part of the plaintiff.

XIII.

There was no commercial economic substance to the plaintiff's transaction with Sam Houston.

XIV.

The plaintiff and Sam Houston did not intend that plaintiff become indebted to Sam Houston.

XV.

No indebtedness of the plaintiff was created by any of the plaintiff's transactions with Sam Houston.

XVI.

The plaintiff's payments were no more than annual premiums, the purchase price of a contract on a deferred payment plan.

XVII.

No money or other economic benefit was received by the plaintiff from Sam Houston.

XVIII.

Neither the $143,465 paid by the plaintiff to Sam Houston [173] in 1953 nor the $147,105 paid in 1954, was a payment of interest.

XIX.

Sam Houston's profit in the transaction was the difference between the 3½% received and the 2½% paid.

Conclusions of Law

I.

This Court has jurisdiction over the parties and of the subject matter.

II.

Plaintiff did not enter into a transaction for profit in the purchase of these bonds.

III.

No indebtedness of the plaintiff was created by

any of the plaintiff's transactions with Sam Houston.

IV.

No personal liability for indebtedness on the part of the plaintiff was created by the plaintiff's transactions with Sam Houston.

V.

There was no commercial economic substance to the plaintiff's transactions with Sam Houston.

VI.

No money or other economic benefit was received by the plaintiff from Sam Houston. [174]

VII.

While in form the payments to Sam Houston were compensation for the use or forbearance of money, they were not in substance. As a payment of interest, the transaction was a sham.

VIII.

Neither the $143,465 paid by the plaintiff to Sam Houston in 1953 nor the $147,105 paid in 1954, was a payment of interest on indebtedness within the meaning of Section 23(b) of the Internal Revenue Code (1939) or Section 163(a) of the Internal Revenue Code (1954), respectively.

IX.

The fact that Section 24(a)(6) of the Internal Revenue Code (1939) does not prohibit a deduc-

tion for an amount paid on indebtedness to purchase an annuity, does not bear on the question as to whether the taxpayer paid interest deductible under Section 23(b).

X.

The defendant is entitled to judgment dismissing the complaint with prejudice and for its costs herein.

Judgment

In accordance with the foregoing findings of fact and conclusions of law,

It Is Hereby Ordered, Adjudged and Decreed that the plaintiffs take nothing, that the complaint be dismissed with prejudice, and that the defendant have its costs herein in the sum of $20.00 (taxed) to be taxed by the Clerk of the Court.

Dated: November 5, 1958.

/s/ WM. C. MATHES,
United States District Judge.

Affidavit of Service by Mail Attached. [175]

[Endorsed]: Filed November 5, 1958. Entered November 6, 1958.

[Title of District Court and Cause.]

NOTICE OF APPEAL

Notice is hereby given that Karl F. Knetsch and Eva Fay Knetsch, plaintiffs above named, hereby appeal to the United States Court of Appeals for the Ninth Circuit from the final judgment entered in this action on November 6, 1958.

McLANE & McLANE,
/s/ By NOLA McLANE,
Attorneys for Plaintiffs. [177]

[Endorsed]: Filed December 1, 1958.

[Title of District Court and Cause.]

ORDER FOR EXTENSION OF TIME FOR FILING AND DOCKETING RECORD ON APPEAL

Motion and Order

Comes now the plaintiffs in the above-entitled case, by their counsel, and move the Court for an order extending the time within which plaintiffs must file and docket the record on appeal to and including March 1, 1959.

/s/ NOLA McLANE by DPC,
Attorney for Plaintiffs.

Order

Pursuant to the foregoing motion for extension of time to file and docket the record on appeal it is hereby

Ordered that the time within which plaintiffs must file and docket the record on appeal in the above-entitled case be extended to and include March 1, 1959.

Dated: January 9, 1959.

/s/ BEN HARRISON,
U. S. District Judge. [180]

[Endorsed]: Filed January 9, 1959.

[Title of District Court and Cause.]

CERTIFICATE BY THE CLERK

I, John A. Childress, Clerk of the above-entitled Court, hereby certify that the items listed below constitute the transcript of record on appeal to the United States Court of Appeals for the Ninth Circuit, in the above-entitled case:

A. The foregoing pages numbered 1 to 185, inclusive, containing the original:

Complaint, filed 5/3/57.

Answer of Defendant, filed 7/3/57.

Plaintiff's Memorandum, filed 10/14/57 (Contentions of Fact and Law).

Defendant's Memorandum of Contentions of Fact and Law, filed 6/20/58.

Plaintiffs' Memorandum in support of Objections to Exhibits 53-61.

Pre-Trial Conference Order, filed 7/22/58.

Minute Order 8/3/58 re trial.

Brief for Plaintiffs, filed 8/27/58.

Defendant's Brief, filed 9/16/58.

Reply Brief for Plaintiffs, filed 10/2/58.

Defendant's Reply Memorandum, filed 10/14/58.

Minute Order 8/5/58, further trial.

Plaintiff's Reply to Defendant's Reply Memorandum, filed 10/20/58.

Minute Order 10/20/58, further trial.

Plaintiff's objections to Defendant's proposed Findings of Fact and Conclusions of Law, filed 11/4/58.

Findings of Fact, Conclusions of Law and Judgment, entered 11/6/58.

Notice of Appeal.

Designation of contents of record on appeal.

Order for extension of time for filing and docketing record on appeal.

Statement of Points upon which Plaintiffs intend to rely on appeal.

B. Plaintiff's Exhibits 1 to 71, inclusive.

C. Two volumes of Reporter's Official Transcript of Proceedings had on: August 4 and 5, 1958 and October 20, 1958.

I further certify that my fee for preparing the foregoing record, amounting to $1.60 has been paid by appellant.

Dated: February 6, 1959.

[Seal] JOHN A. CHILDRESS,
Clerk,

/s/ By WM. A. WHITE,
Deputy Clerk.

In The United States District Court, Southern District of California, Central Division

No. 577-57

KARL F. KNETSCH and EVA FAY KNETSCH,

Plaintiffs,

vs.

UNITED STATES OF AMERICA,

Defendant.

REPORTER'S TRANSCRIPT OF PROCEEDINGS

Los Angeles, California

Monday, August 4, 1958

Honorable William C. Mathes, Judge Presiding.

Appearances: For the Plaintiff: Nola McLane, 210 West Seventh Street, Los Angeles, California; and W. Lee McLane, Esq., 806 Security Building, Phoenix, Arizona. For the Defendant: Laughlin E. Waters, United States Attorney; Edward R. McHale, Assistant United States Attorney, Chief, Tax Division; by Robert H. Wyshak, Assistant United States Attorney. [1]*

Monday, August 4, 1958; 2:00 P.M.

(Other court matters.)

The Clerk: Case No. 577-57-WB, Karl F. Knetsch versus United States of America.

* Page numbers appearing at top of page of Reporter's Transcript of Record.

Mrs. Nola McLane: The plaintiff is ready.

Mr. Wyshak: Ready for the Government.

Mrs. Nola McLane: I am the attorney for the plaintiff, and my name is Nola McLane. I am admitted to practice before this court.

At this time I would respectfully move the admission of W. Lee McLane, Jr., for purposes of this case only.

Mr. McLane is a member in good standing of the Bars of the States of Arizona and New York, and he is admitted to practice before the District Court in both of those states.

The Court: Very well. The motion will be granted.

Are there any issues of fact to be tried in this case? I have been over the file. Has there been a pretrial conference order prepared?

Mr. Wyshak: There is, your Honor.

The Court: There is?

Mr. Wyshak: Yes, your Honor. And signed and filed on July 22nd.

The Court: That is my recollection, but I don't have it here, my copy of it. [2]

Does the plaintiff offer the pretrial conference order in evidence?

Mr. McLane: The plaintiff now offers the pretrial conference order.

The Court: Any objections?

Mr. Wyshak: There are several objections by both the defendant and the plaintiff as to facts stipulated to, your Honor. They are set forth on page 11, paragraph V.

The Court: I am inclined to sustain plaintiff's objection to paragraph 22. I will be glad to hear from the defendant before ruling.

Mr. Wyshak: Well, your Honor, I have not had an opportunity to see the particular exhibits in question, but I submit, your Honor, that it would have bearing on the plaintiff's intent with respect to his purchasing of these annuity saving bonds.

I don't believe there is any question but that the literature referred to in the exhibit was comparable. In other words, there were no differences of substance between the literature sent the plaintiff and this particular exhibit. So that I would submit that it would have——

The Court: Would his intent control the situation?

Mr. Wyshak: It wouldn't control, but it would have some bearing on whether there was any indebtedness.

The Court: His subjective intent? I don't see how [3] it could.

Mr. Wyshak: Well, what I had in mind was, your Honor, the question is whether he intended to purchase an annuity and intended to become indebted, and this particular——

The Court: Well, whether he did or not, he went through the motions, didn't he?

Mr. Wyshak: That is correct.

The Court: And the form is there. The plaintiff isn't challenging the transactions, is he?

Mr. Wyshak: That is true. I think it goes

more to the weight, your Honor, than to the admissibility of it.

The Court: I am just wondering how his subjective intent is relevant at all—his intent as objectively manifested.

Mr. Wyshak: Well, this was literature sent him by the company.

The Court: But is there any showing he acted upon it?

Mr. Wyshak: Well, his action was in purchasing these annuities, your Honor.

The Court: Well, he might have non constat purchased without the literature, might he not?

Mr. Wyshak: I beg your pardon?

The Court: He might have purchased without the literature, might he not? [4]

Mr. Wyshak: He might have.

The Court: I will sustain that objection. However, paragraph 22 of the pretrial conference order on page 10 will remain in the record, if you so desire, as a record of excluded evidence pursuant to Rule 43(c).

Is that your wish?

Mr. Wyshak: Very well, your Honor.

The Court: There is no need of it unless you wish it. If you wish it to remain in the record as a record of excluded evidence, it may.

Mr. Wyshak: I do, your Honor.

The Court: Very well.

That disposes of plaintiff's objections, does it not?

Mr. McLane: That is correct, your Honor.

The Court: Now, the defendant objects to paragraphs 16, 17 and 18.

16 and 17 embrace part of the transaction, do they not?

Mr. Wyshak: Your Honor, the manner in which the Sam Houston treated the sums received from the plaintiff would have no bearing as to the deductibility of those amounts with respect to the plaintiff. Merely the conclusion of the Sam Houston Company as to what they were and that would have no bearing on what your Honor's determination is of the [5] deductibility of these sums.

Mr. McLane: May I respond, your Honor?

The Court: Yes.

Mr. McLane: The Supreme Court of the United States in a case which has been cited by the Government and by the plaintiff in these types of cases was Deputy v. du Pont, 308 U. S. 488. In that decision, your Honor, and in the decision of Old Colony R. Co. vs. Commissioner, 284 U. S. 552, both of which have been submitted to you on brief, the court emphasizes that what interest was depended on what the parties determined the item to be. And in view of that statement, and in view of the Government's position in Revenue Ruling 5494, the basis of which I am positive will be advanced in this matter and which is the basis of the disallowance here, the plaintiff wishes to offer this evidence to show that this transaction did result in interest as to the parties; that it was so designated by them and understood by them; and that if the Government is going to argue substance over form, we be-

lieve that the designation or classification or label placed upon the item by the other party to the transaction is relevant for the purpose of your Honor's decision as to whether the item before you is of is not interest.

The Court: If it is, I should reverse my ruling and adopt Mr. Wyshak's view of 22, should I not, paragraph 22? [6] If the subjective intention of the parties is relevant, then all the surrounding circumstances of the matters relevant to that issue should come in.

Mr. McLane: Your Honor, those facts which the plaintiffs are urging in paragraph 16 are facts that we are offering along with certain exhibits in rebuttal; and I think in view of the fact that your Honor has ruled that paragraph 22 should not be in that I should withdraw paragraph 16 in line with that ruling.

The Court: Well, if the subjective intention of the parties is the test—if that is the test of the substance as opposed to form——

Mr. McLane: Plaintiff thinks it is not, your Honor.

The Court: ——then it all should come in, shouldn't it?

Mr. McLane: That is our position, that if Mr. Wyshak's approach with respect to this advertising comes in, then this material that we are offering in these paragraphs to which he has objected and the exhibits should also come in. But we do not offer it as part of our direct case.

The Court: As part of your case in chief?

Mr. McLane: That is correct, your Honor.

With respect to paragraph 17, your Honor, the only taxable years before you are 1953 and 1954.

The Court: Now, let's go back to this pretrial conference order. I tried to do too much too fast, apparently.

Mr. Wyshak: May I suggest, your Honor, that you take a few minutes to read the whole thing, because we have tried to do a comprehensive job, and it is quite lengthy.

The Court: I read it. I didn't find a copy of it in my file. I read it when it was here before. And I read the file over the weekend, the memorandums.

Is there any objection to Exhibit 1? We will take it up orderly in that fashion. Or, if you can——

Mr. McLane: There was no objection—and Mr. Wyshak of course can correct me—from Exhibits 1 through 52.

The Court: Is that correct?

Mr. Wyshak: That is correct, your Honor. We have set forth our objections succeeding the mention of each exhibit in the pretrial order.

The Court: Very well. Exhibits 1 through 52 are now received in evidence.

(The exhibits referred to, marked Exhibits 1 through 52, were received in evidence.)

Mr. Wyshak: I assume, your Honor, that those are the exhibits referred to in the pretrial order. I believe the pretrial order may have been marked

as Exhibit 1. I am [8] not certain. Will that be cancelled?

The Court: That will be cancelled. It has not been marked. It was merely offered and there was an objection. Is that right, Mr. Clerk?

The Clerk: Yes, your Honor.

The Court: So Exhibits 1 through 52 are received in evidence.

Now, plaintiffs object to Exhibits 53 through 58. There is no objection as to competency, I take it.

Mr. McLane: That is correct, your Honor.

The Court: Objection as to relevancy and materiality.

This has to do with the financial condition of the company?

Mr. Wyshak: Your Honor, may I have them marked for identification?

The Court: Yes. Well, what is the purpose of it, to show the financial condition?

Mr. Wyshak: They are to show, your Honor, the financial condition of the company as bearing on the issue of whether they were in fact annuities or not.

The Court: In other words, whether the company is financially capable of this transaction, is that it?

Mr. Wyshak: That is in part it, yes, your Honor. And in addition to show the amount of the policy loans and the reserves and the fact that almost all of the annuities [9] they sold during the years in question over 90 per cent of the so-called reserves

for those policies were loans. To show the fictitious nature of the——

The Court: Well, that wouldn't be any objection to it, would it? The fact that a man is operating on a shoestring or carrying his insurance on a shoestring wouldn't matter, would it?

Mr. Wyshak: Well, I think it would have a bearing, your Honor, to show the substance of the transaction. In other words, they could have added another zero to it and increased the interest tenfold.

The Court: But that is the inherent part of the transaction, isn't it?

Mr. Wyshak: We have no objection to this exhibit, your Honor.

The Court: No. But the plaintiff does object.

Mr. Wyshak: That is correct, your Honor.

The Court: And what would be the purpose of these exhibits? What do they prove?

Mr. Wyshak: They tend to show the fictitious nature of these bonds; in other words, that there was no economic substance to them. If your Honor will examine the balance sheets as set forth on these exhibits, referring to Exhibit——

The Court: Well, let's assume the company was financial irresponsible to this extent, would that rule the [10] case?

Mr. Wyshak: No, your Honor, it wouldn't; and I am not trying to show that the company was financially irresponsible. I am merely trying to show that the assets and the policies sold, the loans on

the policies were practically equivalent to the policy reserves; and that in fact the annuity saving bonds were not what they purported to be.

In addition, these exhibits——

The Court: How would this tend to show that? How would these exhibits tend to show that?

Mr. Wyshak: Well, these exhibits, first of all, contain balance sheets for each year and——

The Court: Well, what would that show? Suppose the company was in a very precarious financial condition. Would that be a circumstance?

Mr. Wyshak: No, your Honor. This does not affect their net worth or capital. I am not trying to show that they were under-capitalized or anything like that. I am merely looking to the assets and policy reserves. For instance, in the year in question, 1953, they show policy loans of $20,700,000 and policy reserves of $21,591,000.

My point is that these annuity savings bonds were not being sold as annuities. They were being sold on a down payment of less than one per cent of the face value. [11] And they could just as readily have jacked up the amounts of annuities by ten and increased the policy loans by ten, and one washes out against the other.

In addition, these exhibits in the footnotes——

The Court: That will be true whether the company is worth $10,000,000 or ten cents, wouldn't it?

Mr. Wyshak: That would, yes, your Honor.

The Court: Well, how does this help us materially, assuming it to be relevant? I don't see how it is relevant, in the first place, and even if it were relevant, I don't see how it could be material.

Mr. Wyshak: Well, I intend to show, your Honor, that each and every one of these annuity bonds sold by this company were sold on the same basis as to this plaintiff, and that these balance sheets, in addition to other schedules, show that the amount of the policy loans were practically equivalent to the policy reserves.

The Court: There were several of these exhibits, weren't there? Are they in the custody of the clerk?

Mr. Wyshak: There are five such exhibits, your Honor; 53 through 58 for identification.

The Court: And then the defendant objects on through to 70, does it not?

Mr. Wyshak: The defendant objects to Exhibits 59 through 70, your Honor. [12]

The plaintiff also objects to 59, 60 and 61.

Mr. McLane: Everything from 53 on, your Honor, I think is objected to by either one of the two parties.

The Court: Are those exhibits in the custody of the clerk?

Mr. Wyshak: No, your Honor.

The Court: Well, suppose you have them marked. Would there be any inconvenience to counsel to come in tomorrow?

Mr. Wyshak: No, your Honor.

Mr. McLane: That would be perfectly all right, your Honor.

If you are going to consider this overnight, I would like to add—before you exhibit any further thought—that these exhibits, it seems to me, do not

bear upon the issue of whether or not this plaintiff became indebted.

Now, the plaintiff does not dispute the fact, your Honor, that the purchase of this type of annuity was made by borrowing—and I use the term "borrowing" advisedly—on the cash surrender value of the policy. That matter was brought to the attention of the United States Court of Appeals for the Fifth Circuit in an identical case which has been ruled upon by the Fifth Circuit on July 15th.

The Court: Is a copy of the opinion here?

Mr. McLane: I have a copy here, your Honor, which [13] I was going to offer up. And I would ask your Honor leave to consider this opinion before you rule on these exhibits.

The Court: Have you shown it to Mr. Wyshak?

Mr. Wyshak: It's been published. It is in the tax services, so I have seen it.

The Court: Is there any objection to this copy?

Mr. McLane: It's a correct copy.

Mr. Wyshak: No objection, your Honor.

The Court: Suppose you have the exhibits marked by the clerk, and I will follow your suggestion, Mr. Wyshak. I will go over this again in the light of the exhibits, and read this opinion. And if there is no inconvenience, why, I will ask you to come back at 10:00 o'clock tomorrow morning, and we will proceed at that time.

Mr. Wyshak: Very well, your Honor.

The Court: Do you have the exhibits here now?

Mr. Wyshak: Yes, your Honor.

The Court: After adjournment you can hand

them to the clerk, if you will, and he will mark them for identification.

Mr. McLane: Your Honor, may I offer at this time, for the same purpose, those to which Mr. Wyshak is objecting, which are being offered by the plaintiff?

The Court: Yes. I would like to see them all.

Mr. McLane: If your Honor would like an unofficial [14] citation to that case, it is in the 1958 CCH volume advance sheets for July 23rd. It is paragraph numbered 9716.

Mr. Wyshak: If your Honor has the Prentice-Hall tax service more readily available it is paragraph 58-5088.

The Court: Very well, gentlemen.

Anything further, Mr. Clerk?

The Clerk: No, your Honor.

The Court: The trial will be continued until tomorrow morning at 10:00 o'clock.

(Whereupon a recess was taken until 10:00 o'clock a.m. of the next day, Tuesday, August 5, 1958.) [15]

Tuesday, August 5, 1958; 10:00 A.M.

The Court: Any ex parte matters?

The Clerk: No ex parte matters, your Honor.

The Court: You may proceed with the case on trial, 577-57, Knetsch v. United States.

Is it agreed by the plaintiff that the real test here is the substance of the transaction and not the form?

Mr. McLane: Well, that is certainly the Government's argument in these cases, your Honor.

The Court: That is what the Supreme Court says, isn't it?

In other words, the same test is applied here as is applied in one of these partnership cases. Must we look through the form to the substance, in other words, to see what is the economic substance of the transaction?

Mr. McLane: I would agree, your Honor, that that is a proper view in any tax case. But here I would like to add this, that this is a section of the Code which is somewhat different than many of the sections of the Revenue Act. And I noticed yesterday, as in other of these types of cases, some reference was made to economic substance and the general approach of substance over form, and I would like to call your Honor's attention in that regard to this language from Mertens Law on Federal Taxation, paragraph 2601, which will [17] be found in our brief, where the volume says that,

"* * * The deduction for interest differs from some other deductions such as that for business expense in that aside from the express limitations contained in the Code interest paid or accrued is deductible whether it serves a business purpose or not * * *"

And I would submit to your Honor that the language of the section which provides, "all interest paid or accrued on indebtedness" may not be modified by reading into the statute that the transac-

tion must have some sort of economic substance. That's the view of the plaintiff as to this particular deduction claim.

Also there is one other point I would like to make, your Honor, before we go ahead this morning, if I may: It is a little difficult for me to answer your question without covering this material because I am presenting this case, or I expect to present this case to the court on a slightly different basis than the case was presented in Bonn vs. Commissioner; although those arguments will be made, too.

Prior to 1954, as your Honor will see in reading the decision of the Fifth Circuit in the Bonn case, it was fairly clear and I think there is no dispute here that interest paid to purchase a single premium annuity was not disallowed. During the fall of 1953 and the spring of 1954 [18] the Congress, if your Honor will recall, was involved in changing the 1939 Internal Revenue Code. The very transaction which is now before the court and which went before the court in the Bonn case was presented to Congress, both to the Ways and Means Committee and to the Senate Finance Committee. The Commissioner asked that interest paid to purchase single premium annuities be disallowed. As is often the case, the Congress did not give the Commissioner all that he asked. The Congress said, "We will disallow it as to the future, but as to contracts acquired on or before March 1954, we will not disallow." And I ask that your Honor consider this language of the Ways and Means

Committee report which was issued March 1, 1954, respecting this type of transaction.

"Existing law does not extend the denial of the interest deduction to indebtedness incurred to purchase single premium annuity contracts. It has come to your committee's attention that a few insurance companies have promoted a plan for selling annuity contracts based on the tax advantage derived from the omission of annuities from the treatment accorded single premium life insurance or endowment contracts. The annuity is sold for a nominal cash payment with a loan to cover the balance of the single premium cost of the annuity."

And then I call the court's particular attention to this language:

"Interest on the loan which may be a non-recourse loan is then taken as a deduction annually by the purchaser with the resulting tax saving that reduces the real interest cost below the implement and value produced by the annuity. * * *"

and my last sentence of the committee report,

"Your committee bill would deny an interest deduction in such cases——"

"such cases" referring to the example that was just previously set forth——

"but only as to annuities purchased after May 1, 1954."

And I submit, your Honor, that that language

indicates as to the Congress that there was interest in the transaction which we have before your Honor now.

The Court: Otherwise the statute would not have been necessary.

Mr. McLane: It would not be necessary for the Commissioner to ask that it be amended. And certainly when the committee report said "in such cases" they were referring to that type of transaction. And so, while I do not mean to convey that your Honor is in any way limited in this matter, I simply would like my answer to your question to be qualified by that particular language—yes, I would say that the [20] substance over form is a proper issue; but it seems to me this matter has been presented to the Congress of the United States and that its power is paramount and it has been exercised. This particular case arose, as have the single premium annuity cases, as a result of the revenue ruling published on March 9, 1954, nine days after the publication of this committee report, and for the very first time since 1934 the Commissioner began to take the view that in this type of transaction there was no indebtedness. And I am going to argue in my brief that this was an after effect conclusion of the Commissioner in an effort to retain retroactive legislation, which Congress refused to give him.

So, I can't really honestly say that we think indebtedness is the real issue, although obviously there is an interest question, and the answer must be made to the question whether there is or is not in-

debtedness. But in view of that committee language it seems to me that the matter has been presented to the Congress and resolved.

The Court: Very well, gentlemen. Let's take up these exhibits in the pretrial conference order. We admitted Exhibits 1 to 52, inclusive, yesterday, as I recall.

I am of the view that Exhibits 53 through 59 should be likewise admitted. The objections of the plaintiff are overruled. [21]

(The exhibits referred to, marked Exhibits 53 to 59, inc., were received in evidence.)

The Court: Exhibit No. 60, that's the letter to you, Mr. Wyshak, I suppose as a prospective purchaser of an annuity. Is that what it was?

Mr. Wyshak: Yes, your Honor.

The Court: Don't we have the papers in the real transaction here?

Mr. Wyshak: Apparently not, your Honor. But paragraph 22 of the stipulation of facts in the pretrial order sets forth the comparable literature that was sent to Knetsch. We were unable to locate the comparable literature.

The Court: Then this would be admissible as being, in effect, in substance of what was sent to the plaintiff.

Mr. Wyshak: That is correct.

The Court: Very well. The objection will be overruled and Exhibit 60 will be received in evidence. Likewise Exhibit 61.

(The exhibits referred to, marked Exhibits 60 and 61, were received in evidence.)

The Court: That disposes of the plaintiffs' objections.

Now, Mr. Clerk, may I have Exhibits beginning with Exhibit 62 and on to 70, please?

I may have them here. [22]

The Clerk: I think you do have them, your Honor.

The Court: Some of these matters while logically relevant are material in a rather remote degree. But as Mr. Wyshak suggested yesterday, the objection, it seems to me goes to the weight rather than the admissibility of them.

But I am receiving this material as bearing on the issue of whether the transaction had substance as well as form.

Mr. Wyshak: With respect to Exhibits 62 and 63, your Honor, we submit that it's merely one man's opinion in Washington with respect to another taxpayer and in no way binding on this court and in no way binding on the United States.

Mr. McLane: We do not, of course, offer it with any thought that it is binding, your Honor, but merely as rebuttal to the arguments which will be made in the brief, and which these other exhibits which we have already admitted raise with respect to the substance of the transactions and whether or not a tax avoidance was the motive of the participants.

Mr. Wyshak: Your Honor, that correspondence merely relates to whether one man in Washington thinks that Mr. Salley would be entitled to a deduction under certain circumstances. And I sub-

mit that it is completely irrelevant and immaterial to the issues before the court here. [23]

Mr. McLane: Except that that man is a real defendant here, your Honor.

The Court: How do you mean "a real defendant"?

Mr. McLane: The Commissioner of Internal Revenue issued the letter.

The Court: Well, of course, the Commissioner, if he is wrong on the law, he is hopeless, too, isn't he?

Mr. McLane: That is correct. I offer it only for the purpose of rebutting whatever arguments will be made with respect to the tax avoidance purposes of this transaction.

The Court: I don't suppose that the fact that the motive is tax avoidance is material at all if the transaction is a bona fide transaction having substance. The fact that one of the motivations was to save taxes, if that were a ground, why, the Internal Revenue would own the country today, wouldn't it, if that were a ground for disallowance of transactions?

Mr. McLane: Plaintiffs agree, your Honor.

The Court: And I had one the other day that makes me never cease to wonder. The situation there was that a corporation bought a piece of property, staked out a mining claim, spent about $30,000 on it several years ago, and then recently they set up a foundation, charitable foundation and gave the property to the foundation. And if they had sold [24] it, of course, they would have paid what, 25

per cent on the gain? Instead they gave it away. And I suppose their tax is at least 50 per cent. So it is just the same as if someone handed them the difference between the cost and the value, a check for it, with which to pay their income taxes.

But I was told by the attorney for the Government that there was nothing that could be done about it. In fact he doubted even if Congress would do anything about closing that kind of a loophole.

Mr. Wyshak: The Commissioner has always taken the view, perhaps rightly or wrongly, that no income is realized. But I don't think that the clear words of the statute necessarily spell that out, so it would be tenable to argue that the taxpayer did realize substantial economic benefit by giving this property to the foundation and it could be taxable.

The Court: I am glad to hear you say that. That certainly is not an argument that shouldn't be made, I think.

Mr. Wyshak: In fact, your Honor, there is an interesting series of correspondence in Harvard Law Review some years ago by Dean Griswold and someone else regarding such charitable gifts out of inventory, and the approaches are very nicely set forth there.

The Court: I don't recall it. Well, that isn't here.

I will sustain the objections, defendant's objections [25] to Exhibits 62 and 63.

Isn't Exhibit No. 64 in the same category?

Mr. Wyshak: Yes, your Honor.

The Court: I will sustain the objection to those

as self-serving and incompetent, irrelevant and immaterial.

Mr. McLane: May I before you proceed — or shall I wait until you finish—ask that they be received under Rule 43(c) and be considered as excluded?

The Court: Yes. If so desired, both sides, all of these exhibits as to which objections are sustained will be made a part of the record as a record of excluded evidence pursuant to Rule 43(c).

Mr. McLane: Plaintiff does so desire, your Honor.

Mr. Wyshak: We so desire, your Honor.

The Court: Very well.

Mr. McLane: May I add one word on No. 64, your Honor?

The Court: Yes.

Mr. McLane: That letter is a letter issued by the Texas Board of Insurance Commissioners, and I offer that for the reason that in the Bonn case there was some reference made in the opinion to these being valid contracts issued by the insurance company, that when they were issued they were then bound by the laws of the State of Texas. And that has an effect on the non-recourse feature of this loan. And [26] in the revenue ruling the Government argued there was no indebtedness, but which in the State of Texas, under the law of that state, it is required by the state statute. And for those purposes I offer this letter from the Texas Bureau of Insurance Commissioner to show that the contract had been submitted to the Board and that they had

received a letter stating that it had been so submitted.

The Court: Isn't this relevant to the issue, Mr. Wyshak, of substance of the transaction?

Mr. Wyshak: Well, if your Honor will read that letter it appears to me that it merely recites that it was filed with the Texas Board——

The Court: You are speaking of weight now, aren't you?

Mr. Wyshak: Well, I wanted to add this, your Honor. We took the deposition of Mr. Salley, and at that time he testified that whenever they prepared a new contract they merely filed it with the Board of Commissioners.

The Court: Oh, I am not suggesting the weight it had. In other words, this was not an undercover transaction——

Mr. Wyshak: That is correct, it was not an undercover transaction.

The Court: ——without official sanction.

The objection will be overruled as to Exhibit No. 64. [27]

(The exhibit referred to, marked Exhibit No. 64, was received in evidence.)

The Court: Exhibit No. 65.

Mr. Wyshak: I submit, your Honor, that it is merely cumulative since we have stipulated to all the payments, et cetera, surrounding the bonds purchases, and in addition it contains conclusions of the life insurance company as to what those payments were.

The Court: It shows how it was treated on their

records. It seems to me that it's relevant to the issue of the substance of the transaction. It may not have much weight.

Mr. Wyshak: Although not binding on your Honor, in the Bonn case there was a similar offer and——

The Court: Well, I think a ruling could be made either way in the matter——

Mr. Wyshak: Very well.

The Court: ——without any great prejudice to either side and without being reversible error. But I shall receive it as Exhibit 65.

(The exhibit referred to, marked Exhibit No. 65, was received in evidence.)

The Court: Of course, in all of these situations where substance governs over form, why, the form is usually always impeccable in these situations.

Mr. Wyshak: That is correct, your Honor. [28]

The Court: Exhibit No. 66. It seems to me that that would be relevant as rebuttal evidence to the defendant's evidence on the financial condition of the company.

Mr. Wyshak: Your Honor, our objection is more than relevancy. We submit that it is not the best evidence, and contains opinion evidence and conclusions of the person who made this examination.

The Court: Yes, I recall that now. I had overlooked it at the moment.

Mr. McLane: I do not think that by "the best evidence" Mr. Wyshak does not agree this is not an accurate copy of the report.

Mr. Wyshak: That is correct. I don't state that

this report is not an accurate copy of the original report.

Mr. McLane: Plaintiff submits that this is relevant on the substance over form argument that the Government has made, because the insurance commissioner made an examination of this company and treated certain items in his report, not being a participant in the transaction.

The Court: If there are any incompetent opinions in here, the Court of Appeals will indulge this court the presumption that it did not consider any incompetent evidence. The objection will be overruled and Exhibit No. 66 will be received in evidence. [29]

(The exhibit referred to, marked Exhibit No. 66, was received in evidence.)

The Court: I assume the opinions you refer to are the opinions of the examiner.

Mr. Wyshak: Yes, your Honor.

The Court: Well, the opinions to which your object I assume are opinions—if the witness were on the stand he wouldn't be competent to express those opinions and, of course, the court would disregard them. It is like receiving an audit report where the auditor expresses some views that he wouldn't be permitted to express on the stand.

Mr. Wyshak: That is correct.

The Court: Exhibit Nos. 67 and 68.

Mr. McLane: Those are offered in rebuttal again, your Honor.

The Court: Yes. The objection is overruled. They may be received in evidence.

(The exhibits referred to, marked Exhibits 67 and 68, were received in evidence.)

Mr. McLane: May I explain to your Honor why I offered these next two exhibits, 69 and 70?

The Court: Yes.

Mr. McLane: Those are the two income tax returns of these plaintiffs for the two subsequent years to the years involved before, your Honor. They are not offered for any [30] purpose of label or classification, but merely to show this particular transaction as a closed transaction.

I believe it is fair to say that having read the revenue ruling and having once been employed by the chief counsel's office, I expect to be faced with an argument respecting the tax effects of this transaction as it relates to the substance of the transaction. And I think that when these two exhibits, if they are received in evidence, that from them it can be shown that there, in fact, mathematically, dollars and cents, is no tax avoidance; if this transaction is viewed as a closed transaction; that is the opening and closing of it.

Without these two exhibits, your Honor, the two subsequent years' Federal income tax returns, it is possible to argue that the effect of the transactions for the two years before was so many dollars less taxes to these two plaintiffs. Without these two exhibits it will not be possible for the plaintiffs to argue that considering the following two years and the surrender of this contract and the tax effect of the surrender that there was no tax avoidance. And I offer them for that purpose.

Mr. Wyshak: First of all, your Honor, Exhibit No. 65, which is a ledger sheet in the life insurance records, discloses the opening and closing, when it was closed; and I submit that the tax returns for the two later years would [31] have no bearing on this tax avoidance discussion since the taxpayer's income might fluctuate from year to year, and any tax avoidance argument would have to be based on a taxpayer's income substantially level over a period of years.

Now, why Mr. Knetsch may have surrendered the policy when he did in 1956, I don't know. But I submit that it is irrelevant and immaterial to the issue before the court as to whether there was any deduction allowable for the years 1953 and '54.

The Court: It would be admissible, would it not, on the auxiliary issue that the Government raises that this tax gimmick or the transaction is of no substance because it was engaged in solely for tax avoidance. I assume that if the taxpayer said, "Yes, I had in mind avoiding taxes, too, but I considered it a good transaction, also," and you might say it was 80 per cent tax avoidance and 20 per cent good business. I don't suppose the Government could challenge it.

Mr. Wyshak: Well, I don't know.

The Court: The Government could only say that the transaction lacks substance, if the Government could say that it was nothing, as you call it in one of your memorandums, a tax gimmick; that the sole purpose was for tax avoidance, that it had no economic purpose.

Mr. Wyshak: But when the plaintiff purchased it in 1953, or whenever he did, he could not possibly know what [32] the tax effect would be three or four years later. So that we must say that it's after the fact or incompetent to show what his intent may have been at an earlier time.

The Court: What do you say, Mr. McLane, to this suggestion that the purpose for which you offer it has already been met in the evidence?

Mr. McLane: No, your Honor. You see, I face this argument so many times now that I have left the Government about what the tax effects of the transactions are, because the Government persists in viewing these transactions as only a computation that is made from the year before the court and as if there is never an end to the transaction. But every business transaction, and other than business transactions that every citizen of the country goes into, has got to be evaluated in terms of its total tax effect.

The Court: Don't those ledger sheets, Exhibit 65, in effect show that the transaction was closed out?

Mr. McLane: Yes. But they do not show the figures from which computations of a tax effect can be made. In other words, you must have this particular taxpayer's return for those two subsequent years to show exactly what the tax effects were. And that is why I have offered these two.

The Court: How are they shown?

Mr. McLane: For example, in the year that the transaction was closed, your Honor, it shows his

income without [33] giving effect to an interest deduction, showing the surrender of the policies. And based on the Government's position here——

The Court: Of course, I assume when the policy is surrendered the interest will cease and the tax deduction on account of interest would cease. But what bearing would that have upon whether or not it was good while it lasted?

Mr. McLane: Well, your Honor, this is the problem: When contracts are surrendered, when any annuity contract is surrendered, it will be argued in our brief, and the general counsel so states, the Commissioner views the cancellation of the indebtedness as ordinary income to the purchaser of the annuity. In this particular case when this plaintiff surrendered the contract there was $307,000 of ordinary income thereby resulting. If that $307,000 is added to his income for the year 1956, which is Exhibit 70, and the tax computed on that basis, assuming the court should find that interest is an allowable deduction in this case, then the total tax—the plaintiff will argue—exceeds that which he would have paid had he not claimed these interest deductions.

And so it seems to us that it follows that there couldn't possibly be any tax avoidance.

Mr. Wyshak: Your Honor, I think it is clear that what the plaintiff would like is a determination by this court of the tax liability for the year when he surrendered [34] the policy.

Mr. McLane: I recognize, your Honor, that we can't do that since the year is not before the court.

The Court: On these returns, Exhibits 69 and 70, the deduction is taken, isn't it?

Mr. McLane: For the third year, yes, your Honor, but not for the fourth.

The Court: Isn't it taken for both of them? Here is on Exhibit No. 69, interest deduction, interest claimed $150,956.26, and on Exhibit 70, "Miscellaneous deduction, loss on surrender of annuity contract."

Mr. McLane: That is correct, your Honor. In other words, there is a loss if the interest is not an allowable deduction. If the interest is an allowable deduction, then that loss is eliminated from the return and $307,000 must be added to his ordinary income for that year. And that is exactly the argument that I would like to make in my brief.

The Court: It does not appear from these returns?

Mr. McLane: Yes, your Honor. The tax is merely a matter of computing it from the table which appears in the Code.

The Court: Where does the three hundred thousand appear?

Mr. McLane: That appears in the prior exhibit which shows the closing of the transaction in the year 1956, and [35] we have stipulated——

The Court: The "prior exhibit" is No.—you mean the 1955 return, Exhibit No. 69?

Mr. McLane: Let's see, your Honor. I think it's Exhibit—may I see 65, please?

The Court: You mean the ledger sheet?

Mr. McLane: Yes, I believe so.

The Court: The ledger sheet of the company? The life insurance company?

Mr. McLane: Yes. Exhibit No. 65. It shows the closing of the transaction and surrender of the contracts. And I believe there is a stipulation in the statement of facts.

The Court: Well, here again it may have some bearing on the substance of the transaction.

Mr. Wyshak: Your Honor, may I be heard one bit further?

The Court: Yes.

Mr. Wyshak: I know that the year 1956 is presently being audited, and I suspect that the year 1955 is also under audit. And if the taxpayer is introducing these returns to show what his income was and what the tax liability would be, it would seem to me that we are opening up the door to complete liability for the years '55 and '56.

Mr. McLane: I assure the court there is no such purpose in mind at all. [36]

The Court: The plaintiff disclaims it, and I certainly wouldn't adjudicate it.

Mr. Wyshak: Could I have another statement now as to why these exhibits are being offered?

Mr. McLane: Our only purpose in offering Exhibits 69 and 70, your Honor, is to show the court that if the court should conclude that the interest is not a proper deduction—I am sorry. If the court should conclude that the interest is a proper deduction, that the total tax to be paid by this particular plaintiff as a result of that con-

clusion will be greater or equal to the tax he would have paid if the interest was considered not a proper deduction; which then he is putting in issue the amount of tax he should pay for the years '55 and '56, your Honor. And it seems to me that—I never went over this with the agent, but he has introduced no evidence aside from the returns to show what his income was for those years.

The Court: I don't see where that is necessarily so. As I understand it, the plaintiff is asking to assume for the purpose of this case that these other figures are correct. And upon that assumption—and they are presumably correct, are they not—when he verifies the return they are presumably correct.

Mr. Wyshak: I don't think that it is competent evidence for the taxpayer to come into court and say, "Here is my tax return. That is the income I had," and then prove what his income was by introducing a tax return. It's self-serving.

The Court: As I understand it, this situation would be the same whatever his income was that year.

Mr. McLane: I just want you to assume figures that are more realistic than just picking figures out of the air.

The Court: It's just a relative proposition. It is probably more properly argument than evidence. And the plaintiff disclaims any intention to have adjudicated here his income for those years, or his taxes for those years, and it can't be done.

Frankly, I have misgivings, Mr. Wyshak, about the propriety of receiving these, but the purpose

for which the plaintiff offers it appeals to me as being a proper purpose in rebuttal to the issue that this is merely a tax evasion device.

Overruled. Exhibits 69 and 70 will be received in evidence.

(The exhibits referred to, marked Exhibits No. 69 and 70, were received in evidence.)

The Court: Now, we will take up the admitted facts and the objections to those.

There are no objections to the first 15 paragraphs, as I read it. [38].

Paragraphs 16, 17 and 18.

Mr. Wyshak: Evidence comparable to that, your Honor, was excluded in the Bonn case, as I pointed out, over the Government's objection.

The Court: I have received it here. The objection will be overruled and the facts stipulated in paragraphs 16, 17 and 18 on page 8 of the pretrial conference order will be received in evidence on the issue as to the substance of the transaction.

The last two sentences of 19. The objection will be overruled and those will likewise be received in evidence.

Paragraph 20. That has a bearing also on the exhibits we were last discussing, 69 and 70.

Mr. McLane: That is correct, your Honor.

The Court: The objection will be overruled and it may be received in evidence for the purpose stated with respect to Exhibits 69 and 70. That is the purpose, as I understand it, for which they are offered.

Mr. McLane: That is correct, your Honor.

The Court: Paragraph 26.

Mr. McLane: That, again, goes to the question of the avoidance and substance over form. I wanted to offer some evidence showing the extent of this company's other insurance activities than the annuity contracts before the court, and in rebuttal to the exhibits offered by the defendant. [39]

The Court: Very well. For that purpose the objection will be overruled. Paragraph 26 will be received. Likewise, paragraph 27, which I take it is offered for the same purpose.

Mr. McLane: That is correct, your Honor.

Mr. Wyshak: Exhibit 62 referred to in paragraph 30 was excluded. So that to be consistent, it would seem that paragraph 30 should be——

The Court: Is that the one submitted to the Commissioner?

Mr. Wyshak: Yes, sir.

The Court: The objection to paragraph 30 will be sustained.

Paragraph 31. The objection is overruled. Received in evidence. And, likewise, paragraph 32, the objection is overruled. It may be received in evidence.

If it is agreeable, gentlemen, it might be helpful in the record here to have the reporter copy into the record at this juncture paragraphs—we have another objection, don't we?

Paragraph 22.

Mr. Wyshak: That is what I was going to point out. Yesterday you sustained the objection, but I believe consistent with your Honor's rulings today you should overrule it.

The Court: Yes. I will reverse that ruling and

[40] overrule the objection of the plaintiff to paragraph 22 and receive that in evidence.

So, if it is agreeable, the reporter will copy into the record at this juncture paragraphs 1 to 21, pages 5 to 10 of the pretrial conference order, as part of the stipulated facts in the case. Also paragraphs 23 to 29 on page 10 and 11; and paragraphs 31 to 32 on page 11.

That covers it, does it not?

Mr. Wyshak: Did you omit 22, your Honor? 22 is in. It should be 1 through 29 of the stipulation.

The Court: Yes. I am sorry. I am glad you called my attention to that. 1 through 29, pages 5 to 11; and then only 30 will be omitted.

Mr. Wyshak: That is correct.

The Court: 31 and 32 will be copied.

[Note: Paragraphs 1 through 29 of Pretrial Conference Order appearing here are the same as set out at pages 37-43 of this printed record. Paragraphs 31 and 32 at page 43.]

* * * * *

Mr. Wyshak: We have a further oral stipulation, your Honor, which I suggest as follows: That advertisements comparable to Exhibit 59, which are the Wall Street Journal advertisements, were placed by the Sam Houston Life Insurance Company in the Wall Street Journal and in the Journal of Commerce periodically from and after August 1952 up until and through 1957. [48]

Mr. McLane: That is agreed, your Honor.

The Court: What exhibit is that?

Mr. Wyshak: 59, your Honor.

The Court: The Wall Street Journal and the Journal of Commerce?

Mr. Wyshak: Yes, your Honor. The Wall Street Journal, your Honor, has four different editions published throughout the country, and at various times these advertisements were placed in these various editions.

Mr. McLane: That is agreed.

The Court: During the period from when?

Mr. Wyshak: From and after August 1952 through 1957.

The Court: So stipulated?

Mr. McLane: It is so stipulated by the plaintiff, your Honor.

The Court: Received in evidence.

Is there any further evidence to be offered by either side?

Mr. McLane: Nothing to be offered by the plaintiff, your Honor.

Mr. Wyshak: Nothing by the Government, your Honor.

The Court: You both rest?

Mr. McLane: We both rest.

The Court: Have you briefed this as much as you [49] wish? You both indicated you wish to file further briefs.

Mr. McLane: Your Honor, I would appreciate the opportunity of filing, on behalf of the plaintiff, an opening brief. And I ask that I may be granted 30 days to so file.

Mr. Wyshak: We would like to reply, your Honor. And we would like a little oral argument

in order to orient the court with respect to the figures and the transaction. I think it would be simpler verbally rather than——

The Court: I think I would rather hear your oral arguments after I read the briefs.

Mr. Wyshak: That would be fine.

The Court: When will you have your brief in?

Mr. McLane: I would like to have 30 days from today.

The Court: 30 days for the plaintiff. When will the defendant have theirs, Mr. Wyshak?

Mr. Wyshak: Could we have 20 days thereafter?

Mr. McLane: 15 days would be enough for reply, your Honor.

The Court: 30 days plaintiff, 20 days defendant and 15 days to reply. That would take us into October, wouldn't it?

Mr. Wyshak: Yes, it would, your Honor.

The Court: Suppose we continue this matter for oral argument to October 20th at 2:00 o'clock in the afternoon. [50] Is that agreeable?

Mr. McLane: That is agreeable with the plaintiff, your Honor.

Mr. Wyshak: Very well, your Honor.

The Court: That's a Monday.

The Clerk: There is nothing on the calendar.

The Court: Very well. October 20th at 2:00 o'clock for oral argument, gentlemen. It's an interesting case.

Mr. Wyshak: It is, your Honor.

The Court: I am surprised this hasn't been adjudicated before.

Mr. McLane: We are the first ones here, apparently. I think it has a great deal to do, your Honor, with how the service picks certain returns, and sometimes by accident and sometimes——

The Court: Your client happened to be the lucky number, is that it?

Mr. McLane: Yes, your Honor. Certain returns can be picked by an office audit, and I think that is probably how this happened.

The Court: Very well, gentlemen.

Is there any objection to marking the pretrial conference order? You have offered all of it you wish to offer in evidence, have you?

Mr. Wyshak: I assume it isn't necessary to offer [51] the issues as they are set forth, your Honor. It is in the file.

The Court: Well, I mean, all the facts and——

Mr. Wyshak: The facts and exhibits are all in.

The Court: Then let the pretrial conference order be marked as Exhibit No. 71 for identification only. And that way we will have the designation in the record.

Mr. Wyshak: Very well, your Honor.

(The exhibit referred to was marked Exhibit No. 71 for identification.)

The Court: Anything further, Mr. Clerk?

The Clerk: No, your Honor.

Mr. Wyshak: Thank you, your Honor.

Mr. McLane: Thank you, your Honor.

The Court: Very well, gentlemen.

[Endorsed]: Filed January 9, 1959.

[Title of District Court and Cause.]

REPORTER'S TRANSCRIPT OF PROCEEDINGS

Los Angeles, California
Monday, October 20, 1958

* * * * *

The Court: Well, gentlemen, I could take this under submission and write an opinion after some time, but I feel prepared to decide it and I shall decide it now.

As we have discussed, Section 23(b) provides for a deduction of all interest paid or accrued within the taxable year on indebtedness, and so forth. The question here is whether the payments in controversy constitute interest paid or accrued on indebtedness. As the Supreme Court has said, interest on indebtedness usually means compensation for the use or forebearance of money.

It would serve no useful purpose here to go through another analysis of this transaction. We have discussed the non-recourse feature of the transaction and the other features of it. I am of the opinion that while in form the payments were compensation for the use or forebearance of money, they were not in substance, and that as a payment of interest the transaction was a sham.

As to the effect of the 1954 amendment, with all deference to Chief Judge Hutcheson and Judge Brown of the Fifth Circuit whom I respect highly,

I could adopt most readily here the first two paragraphs of Judge Wisdom's dissent. [3]

Finding that the payments in controversy do not constitute interest paid on indebtedness, the Court must necessarily find in favor of the defendant.

Accordingly, findings of fact, conclusions of law and judgment will be ordered in favor of the defendant.

Mr. Wyshak: Thank you, your Honor.

Mr. McLane: Thank you, your Honor.

The Court: It will be interesting to follow the course of this problem. I suspect you will hear some more of it in the future.

Anything further, Mr. Clerk?

The Clerk: No, your Honor.

The Court: Court will adjourn.

(Whereupon at 4:35 o'clock p.m. an adjournment was taken.)

[Endorsed]: Filed February 5, 1959.

[Endorsed]: No. 16356. United States Court of Appeals for the Ninth Circuit. Karl F. Knetsch and Eva Fay Knetsch, Appellants, vs. United States of America, Appellee. Transcript of Record. Appeal from the United States District Court, Southern District of California, Central Division.

/s/ PAUL P. O'BRIEN,
Clerk of the United States Court of Appeals for the Ninth Circuit.

In the United States Court of Appeals
for the Ninth Circuit

No. 16356

KARL F. KNETSCH and EVA FAY KNETSCH,
Plaintiffs-Appellants,

vs.

UNITED STATES OF AMERICA,
Defendant-Appellee.

STATEMENT OF POINTS UPON WHICH PLAINTIFFS INTEND TO RELY AND DESIGNATION OF RECORD

Come now Appellants Karl F. Knetsch and Eva Fay Knetsch, and cite the following points upon which they intend to rely for the reversal of the judgment of the District Court:

1. The District Court erred in finding as fact that plaintiffs' only motive in purchasing ten annuity savings bonds was to attempt to secure an interest deduction.

2. The District Court erred in finding as fact that plaintiffs did not enter into a transaction for profit in the purchase of the ten annuity savings bonds.

3. The District Court erred in finding as fact that no economic gain could be achieved from the purchase of the ten annuity savings bonds without regard to the tax consequences, taking into consideration and compounding the loss of income on the payments made to the company.

4. The District Court erred in finding as fact that the plaintiffs could elect to accelerate the maturity of the ten annuity savings bonds at any time.

5. The District Court erred in finding as fact that the ten annuity savings bonds contained no insurance element whatever.

6. The District Court erred in finding as fact that there was no commercial economic substance to plaintiffs' transaction with the Sam Houston Life Insurance Company.

7. The District Court erred in finding as fact that plaintiffs did not intend to become indebted to Sam Houston.

8. The District Court erred in finding as fact that no indebtedness of the plaintiffs was created by any of the plaintiffs' transaction with the Sam Houston Life Insurance Company.

9. The District Court erred in finding as fact that the plaintiffs' payments were no more than annual premiums, the purchasing price of a contract on a deferred payment plan.

10. The District Court erred in finding as fact that no money or other economic benefit was received by the plaintiffs from the Sam Houston Life Insurance Company.

11. The District Court erred in finding as fact that neither the $143,465.00 paid by the plaintiffs to Sam Houston Life Insurance Company in 1953 nor the $147,105.00 paid in 1954 was a payment of interest.

12. The District Court erred in finding as fact that Sam Houston Life Insurance Company's profit

in the transaction was the difference between the 3½% received and the 2½% paid.

43. The District Court erred in holding that the plaintiffs did not enter into a transaction for profit in the purchase of these bonds.

14. The District Court erred in holding that no indebtedness of the plaintiffs was created by any of the plaintiffs' transactions with the Sam Houston Life Insurance Company.

15. The District Court erred in holding that there was no commercial economic substance to the plaintiffs' transactions with the Sam Houston Life Insurance Company.

16. The District Court erred in holding that no money or other economic benefit was received by the plaintiffs from the Sam Houston Life Insurance Company.

17. The District Court erred in holding that while in form the payments to the Sam Houston Life Insurance Company were compensation for the use or forbearance of money, they were not in substance and that as a payment of interest, the transaction was a sham.

18. The District Court erred in holding that neither the $143,465 paid by the plaintiffs to Sam Houston Life Insurance Company in 1953 nor the $147,105 paid in 1954, was a payment of interest on indebtedness within the meaning of Section 23 (b) of the Internal Revenue Code (1939) or Section 163 (a) of the Internal Revenue Code (1954) respectively.

19. The District Court erred in holding that the fact that Section 24 (a) (6) of the Internal Revenue Code (1939) does not prohibit a deduction for an amount paid on indebtedness to purchase an annuity, does not bear on the question as to whether the taxpayer paid interest deductible under Section 23 (b).

20. The District Court erred in that its decision is not supported by the evidence, it is clearly erroneous, and is not in accordance with law.

21. The District Court erred in holding that the defendant is entitled to judgment dismissing the complaint with prejudice and for its costs herein.

The plaintiffs designate the following portions of the record as certified by the United States District Court for the Southern District of California to the United States Court of Appeals for the Ninth Circuit on February 6, 1959, as necessary for a consideration of the points upon which they intend to rely, and to be printed in the transcript of record:

A. Complaint, filed 5/3/57.

Answer of Defendant, filed 7/3/57.

Plaintiffs' Memorandum in support of Objections to Exhibits 53-61.

Pre-Trial Conference Order, filed 7/22/58.

Minute Order 8/3/58 re trial.

Minute Order 8/5/58, further trial.

Minute Order 10/20/58, further trial.

Plaintiffs' objections to Defendant's proposed Findings of Fact and Conclusions of Law, filed 11/4/58.

Findings of Fact, Conclusions of Law and Judgment, entered 11/6/58.

Notice of Appeal.

Designation of contents of record on appeal.

Order for extension of time for filing and docketing record on appeal.

B. Stipulation for Consideration of Exhibits in their Original Form.

C. Two volumes of Reporter's Official Transcript of Proceedings had on: August 4 and 5, 1958, and October 20, 1958.

D. Statement of Points upon which Plaintiffs Intend to Rely and Designation of Record filed with the United States Court of Appeals for the Ninth Circuit.

McLANE & McLANE,
/s/ By W. LEE McLANE, JR.,
/s/ By NOLA McLANE,
/s/ By JOHN JAY SCHWARTZ,
/s/ By THADDEUS ROJEK,

Attorneys for Appellants.

Notice of Mailing Attached.

[Endorsed]: Filed February 20, 1959. Paul P. O'Brien, Clerk.

[Title of Court of Appeals and Cause.]

STIPULATION FOR CONSIDERATION OF EXHIBITS IN THEIR ORIGINAL FORM

It Is Hereby Stipulated by the parties hereto through their attorneys that the exhibits entered into evidence at the trial of the above-entitled case before the United States District Court for the Southern District of California, being Exhibits 1 through 70, may be considered by this Court in their original form and need not be reproduced to constitute part of the record before this Court.

Dated: February 10, 1959.

/s/ NOLA McLANE,
Attorney for Appellants.

/s/ CHARLES K. RICE,
Assistant Attorney General,
Attorney for Appellee.

[Endorsed]: Filed February 20, 1959. Paul P. O'Brien, Clerk.

[fol. 111] Minute entry of argument and submission—September 17, 1959 (omitted in printing).

[fol. 112]

IN UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

Before: Stephens and Hamlin, Circuit Judges, and Lindberg, District Judge.

MINUTE ENTRY OF ORDER DIRECTING FILING OF OPINION AND FILING AND RECORDING OF JUDGMENT—November 16, 1959

Ordered that the typewritten opinion this day rendered by this Court in above cause be forthwith filed by the Clerk, and that a Judgment be filed and recorded in the minutes of the Court in accordance with the opinion rendered.

[fol. 113]

IN UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

No. 16,356

KARL F. KNETSCH and EVA FAY KNETSCH, Appellants,

vs.

UNITED STATES OF AMERICA, Appellee.

Appeal from the United States District Court
Southern District of California
Central Division

OPINION—November 16, 1959

Before: Stephens and Hamlin, Circuit Judges and Lindberg, District Judge.

Stephens, Circuit Judge

On December 11, 1953, the taxpayers purchased ten single premium annuity bonds from the Sam Houston Life Insurance Company. The purchase price of $4,004,000 was

paid by a note for $4,000,000 and $4,000 in cash. The note was without recourse, and was secured by the annuity bonds. Interest on the note at three and one-half percent per annum, amounting to $140,000 was paid in cash. On December 16, $99,000 was sent to the taxpayers by Sam Houston as an additional loan, and the taxpayers paid the company $3,465 in interest. The bonds bore interest at the rate of two and one-half percent per annum, compounded annually. They matured in thirty years, and at that time would pay the taxpayers a monthly income of $43.00. Maturity could be accelerated or the bonds cashed in, at any time at the taxpayers' option. Mr. Knetsch was sixty when he made the purchase in 1953.

A similar transaction involving an interest payment of $147,105 was entered into for 1954, prior to March 1, when [fol. 114] the provisions of the 1954 Internal Revenue Code affecting interest deductions for annuities went into effect.

These interest payments to Sam Houston were claimed as deductions in the taxpayers' 1953 and 1954 tax returns. When the deductions were disallowed, the deficiencies were paid under protest, and suit was brought in the District Court for refund. The District Court found, with ample support in the record, that the annuity bonds provided neither profit nor insurance; that they had been purchased solely to obtain a tax benefit; and that the alleged interest was not interest in fact, but the purchase price of a tax deduction. From that adverse judgment, the taxpayers have appealed.

This case arises under the Internal Revenue Code of 1939, which allows interest[1] as a deduction from gross income. The issue is whether such payments were payments of interest.

The problem has been carefully considered in *United States* v. *Bond*, 5th Cir., 258 F. 2d 577, which adopted the viewpoint of the taxpayer; and in *Weller* v. *Commissioner*, 3rd Cir., ... F. 2d ....., which agreed with the arguments of the government. We find ourselves in agreement with the opinion expressed by the judges of the Third Circuit.

The judgment of the District Court is affirmed.

[File endorsement omitted]

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[1]Section 23 (b).

[fol. 115] [File endorsement omitted]

IN UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

No. 16,356

KARL F. KNETSCH and EVA FAY KNETSCH, Appellants;

vs.

UNITED STATES OF AMERICA, Appellee.

JUDGMENT—Filed and entered November 16, 1959

Appeal from the United States District Court for the Southern District of California, Central Division.

This cause came on to be heard on the Transcript of the Record from the United States District Court for the Southern District of California, Central Division, and was duly submitted.

On consideration whereof, it is now here ordered and adjudged by this Court, that the Judgment of the said District Court in this cause be, and hereby is affirmed.

[fol. 116] Clerk's Certificate to foregoing transcript (omitted in printing).

[fol. 118]

SUPREME COURT OF THE UNITED STATES
No. 693, October Term, 1959

KARL F. KNETSCH, et al., Petitioners,

vs.

UNITED STATES.

ORDER ALLOWING CERTIORARI—February 23, 1960

The petition herein for a writ of certiorari to the United States Court of Appeals for the Ninth Circuit is granted, and the case is transferred to the summary calendar.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

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